

MONTANA LEGISLATIVE HISTORY

Chapter 163 1989

Bill H 133 S _____

Original bill & history ☒ c

H. Committee on Natural Resources S. Committee on Natural Resources

Hearing Date(s) 1/18 _____ c

Hearing Date(s) 3/03 _____ c

✓ 1/23 _____ c

✓ 3/03 _____ c

_____ c

_____ c

_____ c

_____ c

Date Out _____ c

Did this bill originate in an interim committee? _____ Yes _____ No

Committee _____

Report _____

HOUSE FINAL STATUS

1/25	REFERRED TO BUSINESS & INDUSTRY		
1/27	HEARING		
1/27	COMMITTEE REPORT--BILL CONCURRED		
2/01	2ND READING CONCURRED	41	0
2/03	3RD READING CONCURRED	48	2

	RETURNED TO HOUSE		
2/14	SIGNED BY SPEAKER		
2/14	SIGNED BY PRESIDENT		
2/14	TRANSMITTED TO GOVERNOR		
2/17	SIGNED BY GOVERNOR		
	CHAPTER NUMBER 23	EFFECTIVE DATE:	10/01/89

HB 131 INTRODUCED BY STEPLER, ET AL.
REDUCE PENALTY AND BOND FOR SEAT BELT VIOLATION
TO \$10

1/12	INTRODUCED		
1/12	REFERRED TO HIGHWAYS & TRANSPORTATION		
1/13	FISCAL NOTE REQUESTED		
1/17	HEARING		
1/17	FISCAL NOTE RECEIVED		
1/18	FISCAL NOTE PRINTED		
1/20	COMMITTEE REPORT--BILL NOT PASSED		
1/21	ADVERSE COMMITTEE REPORT ADOPTED	50	40

HB 132 INTRODUCED BY SCHYE
INCREASE MAXIMUM BINGO PRIZE

1/12	INTRODUCED		
1/12	REFERRED TO BUSINESS & ECONOMIC DEVELOPMENT		
1/17	HEARING		
1/18	COMMITTEE REPORT--BILL PASSED		
1/20	2ND READING DO PASS AS AMENDED FAILED	40	56

HB 133 INTRODUCED BY HAYNE, ET AL.
REVISE LAWS RELATING TO STATE OIL AND GAS
LEASE PAYMENTS

1/12	INTRODUCED		
1/12	REFERRED TO NATURAL RESOURCES		
1/13	FISCAL NOTE REQUESTED		
1/18	HEARING		
1/19	FISCAL NOTE RECEIVED		
1/30	COMMITTEE REPORT--BILL PASSED AS AMENDED		
1/30	FISCAL NOTE PRINTED		
2/01	REVISED FISCAL NOTE PRINTED		
2/02	2ND READING PASSED	53	46
2/04	3RD READING PASSED	53	46

	TRANSMITTED TO SENATE		
2/06	REFERRED TO NATURAL RESOURCES		
3/03	HEARING		
3/04	COMMITTEE REPORT--BILL CONCURRED		
3/06	2ND READING CONCURRED	49	1
3/08	3RD READING CONCURRED	48	1

	RETURNED TO HOUSE		
3/14	SIGNED BY SPEAKER		
3/14	SIGNED BY PRESIDENT		

HOUSE FINAL STATUS

3/15 TRANSMITTED TO GOVERNOR
 3/20 SIGNED BY GOVERNOR
 CHAPTER NUMBER 163 EFFECTIVE DATE: 7/01/89

HB 134 INTRODUCED BY BROWN, J.
 PARENTAL CONSENT TO FOREIGN TRAVEL BY A CHILD

1/12 INTRODUCED
 1/13 REFERRED TO JUDICIARY
 1/25 HEARING
 1/25 TABLED IN COMMITTEE

HB 135 INTRODUCED BY MERCER, ET AL.
 REVISE WRONGFUL DEATH AND SURVIVORSHIP DAMAGES

1/12 INTRODUCED
 1/13 REFERRED TO JUDICIARY
 1/19 HEARING
 1/19 COMMITTEE REPORT--BILL PASSED
 1/23 2ND READING PASSED 92 3
 1/25 3RD READING PASSED 92 6

TRANSMITTED TO SENATE
 1/26 REFERRED TO JUDICIARY
 3/09 HEARING
 DIED IN COMMITTEE

HB 136 INTRODUCED BY DEMARS, ET AL.
 REVISE CERTAIN PROVISIONS OF COMMERCIAL FERTILIZERS
 LAW
 BY REQUEST OF DEPARTMENT OF AGRICULTURE

1/12 INTRODUCED
 1/13 REFERRED TO AGRICULTURE, LIVESTOCK & IRRIG.
 1/13 FISCAL NOTE REQUESTED
 1/18 HEARING
 1/18 FISCAL NOTE RECEIVED
 1/19 FISCAL NOTE PRINTED
 1/20 COMMITTEE REPORT--BILL PASSED AS AMENDED
 1/23 2ND READING PASSED 95 0
 1/25 3RD READING PASSED 97 0

TRANSMITTED TO SENATE
 1/26 REFERRED TO AGRICULTURE, LIVESTOCK & IRRIG.
 2/08 HEARING
 2/09 COMMITTEE REPORT--BILL CONCURRED
 2/11 2ND READING CONCURRED 46 0
 2/14 3RD READING CONCURRED 46 1

RETURNED TO HOUSE
 2/18 SIGNED BY SPEAKER
 2/20 SIGNED BY PRESIDENT
 2/20 TRANSMITTED TO GOVERNOR
 2/23 SIGNED BY GOVERNOR
 CHAPTER NUMBER 27 EFFECTIVE DATE: 10/01/89

HB 137 INTRODUCED BY DEMARS, ET AL.
 REVISE CERTAIN PROVISIONS OF COMMERCIAL FEEDS LAW
 BY REQUEST OF DEPARTMENT OF AGRICULTURE

STATUS SHEET

House 51st LEGISLATIVE SESSION
Natural Resources COMMITTEE

Total 80 bills

BILL NUMBER	ENTERED COM. DATE	DATE CON- SIDERED	OUT OF COM.	DO PASS DATE	DO NOT PASS DATE	DO PASS AS AMENDED DATE	DO NOT PASS AS AMENDED DATE	BE CON- CURRED IN DATE	BE NOT CON- CURRED IN DATE	BE CON- CURRED IN AMENDED DATE	BE NOT CONCURRED IN AS AMENDED DATE
HB133	1-12-89	1-18-89	1-25-89			1-23-89					
HB143	1-13-89	1-20-89	3-18-89			3-17-89					
HB241	1-18-89	2-17-89	TABLED 2-17-89								
HB272	1-18-89	1-25-89	TABLED 1-25-89								
HB285	1-18-89	1-23-89	TABLED 1-27-89								
HB327	1-23-89	1-27-89	2-7-89			2-6-89					
HB362	1-24-89	1-30-89	1-30-89			1-30-89					
HB367	1-25-89	2-1-89	2-7-89			2-6-89					
HB380	1-25-89	2-3-89	TABLED 2-8-89								
HB399	1-25-89	2-1-89	2-15-89			2-15-89					
HB413	2-8-89	2-13-89	2-14-89			2-13-89					
HB461	1-27-89	2-1-89	2-1-89	2-1-89							
HB462	1-27-89	2-3-89	2-7-89			2-6-89					
HB463	1-27-89	2-3-89	2-7-89			2-6-89					

Use a separate sheet for Senate Bills, House Bills, and Resolutions.

1 HOUSE BILL NO. 133
2 INTRODUCED BY Hayne
3
4 A BILL FOR AN ACT ENTITLED: "AN ACT GENERALLY REVISING LAWS
5 RELATING TO PAYMENT OF RENTALS, DELAY DRILLING PENALTIES,
6 COMPENSATORY ROYALTIES, AND ROYALTIES ON STATE OIL AND GAS
7 LEASES; ELIMINATING AUTHORITY TO TERMINATE LEASES IN THE
8 ABSENCE OF DRILLING OR PAYMENT OF DELAY DRILLING PENALTIES;
9 AMENDING SECTIONS 77-3-423, 77-3-425, 77-3-427, 77-3-432,
10 AND 77-3-434, MCA; REPEALING SECTION 77-3-424, MCA; AND
11 PROVIDING AN EFFECTIVE DATE."

12
13 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

14 **Section 1.** Section 77-3-423, MCA, is amended to read:

15 "77-3-423. Annual rental. (1) The annual money rentals
16 to be paid to the state for oil and gas leases issued on and
17 after July 1, 1975, shall be set by the board but may not be
18 less than \$1.50 for each acre of land leased.

19 (2) In addition to the sum of \$1.50 per acre, the
20 rental for the first year of the lease shall also include
21 any sum in excess of \$1.50 per acre offered and accepted for
22 the first year's rental.

23 (3) This annual rental shall in no case be less than
24 \$100 a year.

25 (4) The first year's rental shall be paid before the

1 issuance of the lease. The rentals for each subsequent year
2 of the lease shall be due and payable before the beginning
3 of such subsequent year, and upon failure to make such
4 payment, the lease terminates unless there is a producing
5 well on the lease. Rental paid for any year shall be
6 credited against any royalty that accrues during that year."

7 **Section 2.** Section 77-3-425, MCA, is amended to read:

8 "77-3-425. Dry hole clause. If the first well drilled
9 is a dry hole and if a second well is not commenced on the
10 land covered by the lease before the next anniversary of the
11 lease following the completion of the well, the lease may be
12 terminated by the board unless the lessee, on or before such
13 anniversary, ~~resumes--the--payments--of--penalties--in--the~~
14 ~~amounts--provided--in--77-3-424--Upon--the--resumption--of--the~~
15 ~~payment--of--such--delay--drilling--penalties--and--their--continued~~
16 ~~payment--the--lease--continues--in--force--during--the--primary~~
17 ~~term--as--though--there--had--been--no--interruption--in--the--delay~~
18 ~~drilling--penalty--payments~~ continues to pay an annual rental
19 as set forth in 77-3-423."

20 **Section 3.** Section 77-3-427, MCA, is amended to read:

21 "77-3-427. Provision for offset wells -- compensatory
22 royalties. (1) Oil and gas leases granted by the state shall
23 contain suitable provisions imposing upon all lessees the
24 obligation to drill offset wells wherever and whenever
25 necessary to prevent waste and damage to the property of the

1 state.

2 (2) The board may allow the lessee the option--of
3 following options in lieu of drilling an offset well:

4 (a) releasing the lands in question; or

5 (b) paying a compensatory royalty on a nonproducing
6 lease in-lieu-of-drilling-an-offset-well if it determines
7 that such compensatory royalty will fully compensate the
8 state for waste and damage to the property of the state. The
9 compensatory royalty shall be based upon the estimated
10 drainage, as determined by the board, and shall be paid on a
11 monthly basis unless circumstances require otherwise."

12 **Section 4.** Section 77-3-432, MCA, is amended to read:

13 **"77-3-432. Royalty.** In every oil and gas lease granted
14 by the state under this part and acts amendatory thereto,
15 there shall be reserved to the state as consideration
16 ~~therefor,--in--addition--to--the--rentals--as--hereinbefore~~
17 provided, a royalty in on all oil and gas produced and saved
18 from all lands covered thereby and not used for light, fuel,
19 and operation purposes on the leased premises, which shall
20 be equivalent to the full market value, as ascertained by
21 the board at the date of such lease, of the estate or
22 interest of the state in the lands and oil and gas deposits
23 disposed of under such lease. Such royalty reservation shall
24 be set by the board but may not be less than 12 1/2% on gas
25 and not less than 12 1/2% on that portion of the average

1 production of oil or casinghead gasoline for each producing
2 well not exceeding 3,000 barrels for the calendar month. The
3 state may share the expense of transporting the oil to the
4 nearest market on a basis proportional to the state's
5 royalty interest in such oil and at a rate per mile
6 acceptable to the department."

7 **Section 5.** Section 77-3-434, MCA, is amended to read:

8 **"77-3-434. Manner of making royalty payment.** Such A
9 lease shall provide for the rendering of payment of such the
10 royalty on all oil and gas produced and saved and sold or
11 used off the premises in the following manner and upon the
12 following terms:

13 (1) the lessee shall pay to the state in cash, for all
14 oil and gas royalty reserved, the posted field price
15 existing on the day such oil or gas is run into any pipeline
16 or storage tank to the credit of the lessee, plus any bonus
17 actually paid or agreed to be paid to the lessee for such
18 oil or gas; or

19 (2) at the option of the state, exercised in writing
20 by the board not oftener more frequently than every 30 days,
21 the lessee shall deliver the state's royalty oil or gas free
22 of--cost--or--deductions into the pipeline to which the wells
23 of the lessee may be connected or into any storage
24 designated by the state and connected with such wells."

25 NEW SECTION. **Section 6.** Repealer. Section 77-3-424,

1 MCA, is repealed.

2 NEW SECTION. **Section 7.** Extension of authority. Any
3 existing authority to make rules on the subject of the
4 provisions of [this act] is extended to the provisions of
5 [this act].

6 NEW SECTION. **Section 8.** Effective date. [This act] is
7 effective July 1, 1989.

-End-

In compliance with a written request, there is hereby submitted a Fiscal Note for HB133, as introduced.

DESCRIPTION OF PROPOSED LEGISLATION:

HB 133 revises terms of state oil and gas leases, including payments of rentals, delay drilling penalties, and compensatory royalties. The bill proposes to drop lease rentals on producing leases, eliminate the non-drilling penalty that takes effect in the 6th through the 10th year of the lease, and allow the lessee to reduce the royalty with production costs and deductions. The bill also proposes to allow lessees to evade liability for drainage of the lease by offset wells drilled adjacent to the lease.

ASSUMPTIONS:

1. The number of acres leased is directly responsive to the price of oil.
2. The number of producing acres will remain constant at approximately 180,000 acres.
3. There will be continued drilling on tracts adjacent to state lands that may cause drainage of oil from state lands. Staffing requirements and workload will increase in order to detect and mitigate losses before they occur since this bill will eliminate the current ability to demand payment of past losses.
4. Oil field production and drilling will continue to cause long-term damage to state-owned surface acres. The state accepts annual rentals during production in lieu of assessed damages. Currently rentals are \$270,000 annually on producing leases.
5. In order to make oil and gas marketable, it is required to be processed and transported to market. The proposed bill will allow the lessee to deduct those costs from royalties. It is nearly impossible to determine reasonable costs and deductions. This bill would increase the need for accounting auditing and inspection staff to verify these costs.

FISCAL IMPACT:

Expenditures:

	Current	FY90 Proposed	
	Law	Law	Difference
Personal Services	-0-	\$302,330	\$ 302,330
Operating Expenses	-0-	72,832	72,832
Equipment	-0-	15,000	15,000
	-0-	\$390,162	\$ 390,162

	Current	FY91 Proposed	
	Law	Law	Difference
Personal Services	-0-	\$302,330	\$ 302,330
Operating Expenses	-0-	72,832	72,832
Equipment	-0-	-0-	-0-
	-0-	\$375,162	\$ 375,162

Funding:

General Fund	-0-	\$390,162	\$ 390,162
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	-0-	\$375,162	\$ 375,162
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Revenue:

Trust Fund	\$270,000	-0-	(\$270,000)
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	\$270,000	-0-	(\$270,000)
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Ray Shackelford 1/19/89
 RAY SHACKLEFORD, BUDGET DIRECTOR DATE
 OFFICE OF BUDGET AND PROGRAM PLANNING

Harriet Hayne 1/28/89
 HARRIET HAYNE, PRIMARY SPONSOR DATE

Fiscal Note for HB133, as introduced

HB 133

LONG-RANGE EFFECTS OF PROPOSED LEGISLATION:

1. If the legislation is passed, the trust will lose \$500,000 in 1994 and annually thereafter because of the elimination of the delayed drilling penalty.
2. Current bonuses, rentals and delay penalties are at their lowest level in a decade. When oil prices rise, there will be a proportional rebound in leasing activity and an increase in revenues regardless of the terms of the state leases. The amount and time of this occurrence is difficult to predict but is inevitable considering national dependence upon hydrocarbons.

In compliance with a written request, there is hereby submitted a Fiscal Note for HB133, Second Reading.

DESCRIPTION OF PROPOSED LEGISLATION:

HB133 revises terms of state oil and gas leases, including payments of rentals, delay drilling penalties and compensatory royalties. The bill proposes to drop lease rentals on producing leases and provide for refund of delay drilling penalties for years in which drilling occurs.

ASSUMPTIONS:

1. The number of acres leased is directly responsive to the price of oil.
2. Oil field production and drilling will continue to cause long-term damage to state-owned surface acres. The state accepts annual rentals during production in lieu of assessed damages under current law. These rentals currently are \$270,000 annually on producing leases.
3. Due to proposed law lost rentals on producing leases, DSL will lose income at the rate of \$27,000 in FY92, \$36,000 in FY93, \$45,000 in FY94 and additional losses of \$9,000 per year thereafter until the current income level of \$270,000 per year is reached.
4. DSL will have to inspect and assess all damages associated with drilling and production on new leases. This will require 0.50 FTE and related operating expenses in FY90 and 1.00 FTE and operating expenses in FY91 and thereafter.
5. The number of new wells will be approximately 15 per year, which is the 1988 level, and the average lease containing new wells will be approximately 400 acres.
6. Damage payments recovered by field assessment will reimburse the trust fully for actual damage done, and will improve the condition of trust lands by enforcing clean-up and reclamation.
7. In 1994, 40% of the wells drilled will be leases held 6 through 10 years and delayed drilling penalties will be refunded for any year in which a well is drilled.
8. Due to refunded delayed drilling penalties, DSL will lose \$3,000 in FY94, \$6,000 in FY95, and \$6,000 per year thereafter, based on 15 new wells per year x 40% x 400 acres x \$1.25 = \$3,000 in FY94 for year 6 of the lease, and a rate of \$2.50 for years 7 through 10.

FISCAL IMPACT:

<u>Expenditures:</u>	Current	FY90	<u>Difference</u>	Current	FY91	<u>Difference</u>
	<u>Law</u>	<u>Law</u>		<u>Law</u>	<u>Law</u>	
Dept. of State Lands	-0-			-0-		
Personal Services	-0-	\$12,500	\$12,500	-0-	\$25,000	\$25,000
Operating Expenses	-0-	1,750	1,750	-0-	3,500	3,500
Equipment	-0-	15,000	15,000	-0-	-0-	-0-
Total	-0-	\$29,250	\$29,250	-0-	\$28,500	\$28,500
<u>Funding:</u>						
General Fund	-0-	\$29,250	\$29,250	-0-	\$28,500	\$28,500
<u>Revenues:</u>						
Trust Fund	\$270,000	\$270,000	-0-	\$270,000	\$270,000	-0-

Ray Shackelford 2/1/89
 RAY SHACKLEFORD, BUDGET DIRECTOR DATE
 OFFICE OF BUDGET AND PROGRAM PLANNING

Harriet Hayne
 HARRIET HAYNE, PRIMARY SPONSOR DATE

Fiscal Note for HB133, on second reading

**HB 133-Second
Reading**

LONG-RANGE EFFECTS OF PROPOSED LEGISLATION:

In FY92 the lost trust revenue will be \$27,000 and this will accelerate to \$270,000. Damage payments and the improved condition of state lands will act as an offset to the lost rentals.

HB 133

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 51st LEGISLATURE - REGULAR SESSION

COMMITTEE ON NATURAL RESOURCES

Call to Order: By Chairperson Bob Raney, on January 18,
1989, at 3:00 p.m.

ROLL CALL

Members Present: All present except:

Members Excused: Rep. Addy, Rep. Harper

Members Absent: None

Staff Present: Claudia Montagne, Secretary; Hugh Zackheim,
Staff Researcher, Environmental Quality Council

Announcements/Discussion: REP. COHEN distributed two reports from the National Solid Waste Contractors' Association and encouraged the committee to read them in order to be informed on this issue. CHAIRPERSON RANEY mentioned that he had distributed an article from the Massachusetts Audubon Society on garbage, and that this will be a significant issue for Montana, especially its rural communities. He stated that infectious waste management issues would also be important issues for this committee and during this session.

HEARING ON HB 133

Presentation and Opening Statement by Sponsor:

REP. HARRIET HAYNE, House District 10, presented a written opening statement (EXHIBIT 1).

List of Testifying Proponents and What Group They Represent:

Jack King, Landman, Hancock Enterprises and President,
Montana Petroleum Association
Doug Abelin, Montana Oil and Gas Association
Gary Willis, Montana Power Company

List of Testifying Opponents and What Group They Represent:

John North, Interim Commissioner, Dept. of State Lands

Testimony:

JACK KING testified in favor of HB 133, submitting written testimony (EXHIBITS 2 and 3).

DOUG ABELIN testified in favor of HB 133, stating that he supported the bill on the grounds that the volumes of production were low, and that double payments were hard on the industry.

GARY WILLIS testified in favor of the bill, stating that his company had several state oil and gas leases, as well as fee leases. They felt that this legislation brought Montana in line with leasing practices in other states and with fee leasing wording.

JOHN NORTH testified against the bill, stating that the department agreed that fostering oil and gas development is positive for Montana, but that it must be done in accordance with state law. The points of his testimony are contained in EXHIBIT 4. The department also presented amendments (EXHIBIT 5) regarding the offset well sections. Basically, the amendments would allow the state to charge compensatory royalties until the lease was dropped, if a lessee chose to drop a lease instead of drilling an offset well. Mr. North stated that this provision would provide for protection of the state's trust assets, and that there would be constitutional implications without this amendment.

MR. NORTH added that there was a technical error in the title of the bill, and that the Board of Land Commissioners would still have "authority" to impose delay drilling penalties.

Questions From Committee Members:

REP. KADAS asked for the results of the fiscal note, and Mr. North answered that there would be a \$540,000 loss to the trust beginning in 1994, and additional expenditures of \$765,000. These expenditures come from additional expenditures necessary to monitor leases, accounting and auditing requirements by the allowing of deductions from the royalties, and the auditing required if the offset provision is enacted. At this

time, the department (DSL) does not have a good way of determining when leases are being drilled adjacent to state sections.

ROD SAMDAHL, Petroleum Geologist from the Department of State Lands elaborated, saying that there is a problem with detecting drainage on state lands. There is a lot of land and a small staff. Only way to track would be a program similar to the one utilized by the Bureau of Land Management (BLM), but scaled down. He figured this to be 10% of all oil and gas royalties, and this constituted the amount in this section of the fiscal note.

REP. GILBERT asked if industry representatives would reply to some of these remarks and the proposed costs. Mr. King replied that only four wells are being drilled now, and the maximum at any one time would be 10-11 wells. The drop in revenue is a reasonable estimate, but these expenditures would not warrant such a program or expenditures. There are publications available to the state to enable them to keep up with the information they would need. The drop in revenue, while reasonable, does not include the increased royalties and increases in leases. He said that the \$1.50 lease cost is a compromise, and that most states charge \$1.00. He stated that it is easy to keep track of offset wells, and that the correlative rights of the state and private entities are protected. By current laws, the state would be notified and there would be a hearing. He does not see the fiscal impact.

REP. GILBERT asked if the wells were on public or private land, and Mr. King answered that they were on both. Janelle Fallan added that in regards to the inspection question, there were approximately 20 wells drilled last year on state land in Montana, and those would need to be inspected before, during and after production. She did not see this process taking a lot of personnel or expenditure.

REP. GILBERT asked Ms Fallan asked if the Oil and Gas Conservation Commission inspected wells, and she answered that they inspected those on private and state lands.

REP. HANNAH asked Mr. North about the constitutional problem that he mentioned, and he replied that it is the constitutional requirement of the state to obtain full

market value for its assets. This is in the Enabling Act of the Constitution. With regards to the drainage question, there would be a drainage of the state's assets. Regarding the delayed drilling penalty, this is a judgement call, and would not pose constitutional questions.

REP. HANNAH then asked if there would still be a constitutional problem if the offset situation were to be solved. Mr. North said yes, in that the department believed that the returns would be greater to the state with the retention of the delayed drilling penalty. However, the state would probably not be susceptible to a lawsuit. Mr. North added that if the offset problem were to be solved, so also would the fiscal problem, because that was where the greatest monetary cost came.

REP. HANNAH asked about the "authority" issue that Mr. North had mentioned. Mr. North stated that the elimination of the statute on delayed drilling penalties and the charge of the Board of Land Commissioners would not eliminate their authority to control State Lands and impose delayed drilling penalties. He stated that it would, as Rep. Hannah said, be a strong suggestion, but not a legal prohibition. He stated that while that might have been the intent of the bill, it does not accomplish this.

REP. GIACOMETTO asked for clarification of the issue of correlative rights. Mr. King said that state statute said that you cannot drain your neighbor's well, and that there was monitoring by the Board of Oil and Gas on both state and private entities. Tom Butler, the Oil and Gas Attorney for DSL, said that the state was not protected by current oil and gas conservation statutes against an operator who was not prudent; that is, one who did not follow the implied covenant to drill an offset well. He said that DSL's concern was that they would not be able to collect the penalty when the operator or lessee had not been prudent in protecting his lease. Jerome Anderson said that the bill only put the state in the same position as the private landowner.

REP. RANEY requested an explanation of the bill in language that the committee could understand from the oil and gas industry, and the same from the Department of State Lands.

Closing by Sponsor:

REP. HAYNE closed, stating that she thought that the oil and gas industry could use this bill, and encouraged a do pass from the committee. She also submitted amendments in EXHIBIT 1.

DISPOSITION OF HJR 1

Hearing 1/13/89

Motion: REP. COHEN moved DO NOT PASS.

Discussion: REP. HANNAH stated that his understanding is that Rep. Swysgood is working on a similar issue, and suggested that the committee consider tabling the bill until the committee sees Swysgood's bill.

REP. RANEY replied that if Rep. Swysgood were to submit another proposal, it would have to be significantly different from this bill in order to be considered; otherwise, if it were similar, it would meet the same fate as HJR 1.

REP. OWENS stated that the object of HJR 1 was not to argue one way or another about the amount of wilderness, but to indicate to Congress that it's time to get on with things. He suggested that we are a "used" society, and that people know that these issues are close to us, and they are going to keep using the process. The attorneys and executive directors are not going to want this wilderness issue solved, he suggested. He stated that he would like the bill to pass.

REP. RANEY countered with the statement that HJR 1's intent was to not merely resolve the issue, but to resolve the issue Rep. Swift's way, or the Forest Service's way.

REP. ROTH made a substitute motion to TABLE the bill. The motion FAILED 10 to 6 on a roll call vote, with Reps. Clark, Gilbert, Hannah, Owens, Roth, and Smith voting yes.

Amendments and Votes: None

Recommendation and Vote: On the original motion DO NOT PASS, the motion CARRIED 13 - 3 with Reps. Clark, Gilbert, and Owens voting no.

DAILY ROLL CALL

HOUSE NATURAL RESOURCES COMMITTEE

50th LEGISLATIVE SESSION -- 1989

Date 1-18-89

NAME	PRESENT	ABSENT	EXCUSED
Rep. Bob Raney, Chairman	✓		
Rep. Ben Cohen, Vice-Chairman	✓		
Rep. Kelly Addy			✓
Rep. Vivian Brooke	✓		
Rep. Hal Harper			✓
Rep. Mike Kadas	✓		
Rep. Mary McDonough			
Rep. Janet Moore	✓		
Rep. Mark O'Keefe	✓		
Rep. Robert Clark	✓		
Rep. Leo Giacometto			✓
Rep. Bob Gilbert	✓		
Rep. Tom Hannah	✓		
Rep. Lum Owens	✓		
Rep. Rande Roth	✓		
Rep. Clyde Smith	✓		

Mr. Chairman, for the record I am Rep. Harriet Hayne, House District 10, most of Pondera County and part of Glacier County.

Mr. Chairman and members of the Committee, I bring you HB 133.

HB 133 is intended to deal with an area of state law in which Montana operates differently than other states, and in so doing, to improve revenues to education and state and local governments.

The purpose of state lands is to generate income for the schools. That is why the Enabling Act set up the permanent school trust fund and dedicated sections 16 and 36 of each survey township to that fund. As you may know, 95 per cent of royalties from state lands go to the constitutional permanent school trust and 95 percent of all rentals are divided among the schools, under Article X of the Montana Constitution.

The state owns more than six million acres in Montana, about 7 per cent of the state. One way it realizes income from these lands is to lease the underlying minerals.

Oil and gas leases on state minerals are sold at auction four times a year. The sale produces at least two forms of income for the state -- the bonus bid, and an annual rental. In FY 1987, bonus payments totaled \$179,449. The annual rentals, of \$1.50 per acre, totaled \$2,315,606. The state realizes the most income when wells are successfully drilled and it receives a royalty of 13 per cent on oil and 12-1/2 per cent on gas. In FY 1987, royalties totaled \$3,466,628.

An article in the Public Land Law Review, Volume 3, 1982, dealt with school trust lands and royalties. On the importance of royalties, it stated: "The royalty is the most important form of compensation, not only because it represents the most money, but also because it represents payment for the removal of the mineral."

State leasing activity and subsequent income to the trust have dropped significantly in recent years, and that is part of the reason that we are here. In the past five years, the number of acres under lease has declined 60%. Oil royalties have declined 56%, gas royalties 34%. Rentals have declined 59% and bonus bids are down a whopping 96%. The petroleum industry has also declined in the past three years, but not to this extent. For example, the price of oil has declined 40%, and production in Montana is down 22%.

Leasing of state minerals is an area in which it is important for Montana to become competitive with other states, and that is what this bill contemplates. We're not proposing to be better -- just to lease the way other states do.

The first change is to eliminate the rental on producing lands. Rental payments were originally established in oil and gas law to provide income to the lessor (the state, in this instance) until production is established and the lessor receives royalty income. In Montana, rentals have been charged on producing lands rather than compensation for surface damages. However, operators expect to pay for surface damages, reclaim the surface, and recompense the surface owner for land lost to production. Montana is the only state that charges rentals even when a royalty is being paid.

Eliminating the delay drilling penalty is also proposed, as it causes the state to lose leases. It is less expensive for a lessee to drop the lease after the fifth year and rebid it than to pay the delay drilling penalty. The penalty is currently required even if the lessee is in the process of drilling.

The third proposal is to allow the lessee to drop a lease if it is not economic to drill an offset well. Under current statute, the lessee is forced either to drill an offset well or pay a compensatory royalty. This puts the state in the position of making economic decisions, rather than the operator.

Even in a downturn, the taxes paid by the petroleum industry in Montana are significant -- nearly \$108 million in state and local taxes and royalties last year. Looked at from the perspective of local governments, one 50-barrel oil well will generate as much local property tax as 6240 cows; 79,047 grazing acres or 11,773 acres of tillable land. And about 60% of the local property taxes on oil and gas support the local schools.

The same Public Land Law Review article quoted earlier said, "The only goal of state level management is the production of sustained income for the maintenance of the public schools."

Some change is necessary to halt the decline in state leasing, for the protection of the schools' income. HB 133 will help accomplish that.

1
1-18-89
133

Proposed amendments to HB 133

Page 2, lines 7-19

repeal 77-3-425

Page 3, line 6

lease in lieu of drilling an offset well if it THE BOARD
determines

Page 4, lines 21 and 22

the lessee shall deliver the state's royalty oil or gas free of
cost or deductions FREE OF COST OR DEDUCTIONS into the pipeline

Page 5, line 1

MCA, ~~is~~ AND SECTION 77-3-425, MCA, ARE repealed.

~~line 7~~

~~effective July 1, 1989 JUNE 1, 1989.~~

STATE LANDS
OIL AND GAS REVENUE COMPARISON, FY 84 to FY 88

ITEM	FY 84	FY 85	FY 86	FY 87	FY 88	DECLINE, 1984-1988
Acres under lease	4,167,507.57	3,782,051.59	3,161,019.87	2,075,586.56	1,639,500.40	60%
Acres terminated or expired	192,574.80	643,726	880,264	239,898.21	106,475.40	
Oil Royalties	\$5,978,431	\$5,110,268	\$4,193,476	\$2,373,093	\$2,593,297	56%
Gas Royalties	1,329,198	1,364,853	1,248,139	910,782	873,331	34%
Oil and gas rentals	5,734,132	5,165,457	4,179,649	2,853,173	2,315,606	59%
Bonuses	5,067,079	1,193,789	771,130	225,750	179,449	96%
Non-drilling penalty	2,339,310	3,351,509	3,238,254	2,025,767	1,504,349	36%

(Information supplied by Department of State Lands, January 1989)

FY 84 figure June 1984, FY 85 figure June 1985, etc.

Calendar year					
Oil production	30,668,305 bbl			23,996,000	22%
Gas production	48,499,939 MCF			39,000,000	20%
Oil price	\$28.066			\$16.622	40%
Gas price	\$ 2.512			\$ 2.061	18%
Oil wells	4201			4050	3.6%
Gas wells	2088			2100	—

f25/stlands

INFORMATION SHEET
HB 133

EXHIBIT 2
DATE 1-18-89
PAGE 133

An oil and gas lease with the state currently requires a "bonus" bid of at least \$1.50 per acre, an annual rental of \$1.50 per acre whether or not the lease is producing, a non-drilling penalty of \$1.25 per acre per year starting in the sixth year of the lease if it is not drilled, and a royalty of 13 per cent on oil and 12-1/2 per cent on gas.

MPA proposes to drop the rental charge on producing tracts. Rental payments were originally established in oil and gas law to provide income to the lessor (the state, in this instance) until production is established and the lessor receives royalty income. Montana is the only state that charges rentals even when a royalty is being paid.

Eliminating the delay drilling penalty is also proposed, as it causes the state to lose leases. It is less expensive for a lessee to drop the lease after the fifth year and rebid it than to pay the delay drilling penalty. The penalty is currently required even if the lessee is in the process of drilling.

The downturn in the oil industry in the latter half of the 1980s has caused a decline in state leasing that has been exacerbated by Montana's non-competitive leasing laws with respect to other states. Income from leasing state minerals helps fund education in Montana, and greater interest in state leasing will improve contributions to the educational trust fund.

Oil and gas royalties were \$3,283,875 for FY 1987 and \$5,441,615 for FY 1986.

Montana Petroleum Association
1/13/88

~~newsletter/lease~~

EXHIBIT 5
DATE 1-18-89
HB 133

TO: HOUSE NATURAL RESOURCES COMMITTEE

FROM: JACK E. KING, LANDMAN
HANCOCK ENTERPRISES
Suite 500, Petroleum Building
Billings, MT 59101 252-0576
President, Montana Petroleum Association

RE: HB 133 STATE OIL & GAS LEASING BILL

The regulations for oil and gas leasing on State lands has several onerous features which this Bill addresses. The intent of this Bill is to remove glaring inconsistencies and make our regulations more consistent with our neighboring states and with common industry practice.

After the 5th year of a State lease the delay drilling penalty in 77-3-424 calls for an additional \$1.25 per acre per year rental penalty on top of the existing \$1.50 per acre per year rental, regardless of drilling activity on the lease. This "penalty" is unique among standard industry leases and among counterpart Rocky Mountain states. Therefore, we recommend the deletion of 77-3-424 "the delay drilling penalty".

Section 1: The change at the end of the Section (page 2, lines 4-6) frees producers from having to pay rentals and royalties. Common lease language dictates that once you establish production the lessee pays royalties, in lieu of rentals.

Section 2: This Section can be deleted in entirety as it is covered above. The language that is stricken, along with 77-3-424, deals with the delay drilling penalty, which we previously discussed.

Section 3: Currently, if a non-producing State lease offsets a producing well, the State, as lessor, can demand that an operator pay compensatory royalties (royalties based upon estimated drainage) or require the operator to drill a test well. The new language affords the lessee the chance to drop the lease, if the lessee does not feel that the tract has sufficient merit to warrant further activity. There are a variety of reasons the lessee may want to drop the lease, the most obvious being they may not have the capital or desire to drill a test well or pay compensatory royalties. This clause specifically addresses unusual circumstances whereby the State would feel a tract is prospective and the lessee feels that the tract is not economic, at that particular time for that particular operator. If released by the lessee the State would put the tract back up for bid, at one of their sales, and receive the added benefit of additional bonus income with the stipulation of drilling a well or paying compensatory royalties.

Section 4. The deletion of the language "in addition to the rentals as hereinbefore provided" (page 3, line 16), addresses the same questions as Section 1, the elimination of paying royalty and rentals.

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1-18-89
123

As this type of language is unique to our State, it is yet another example thrown up to those of us living in Montana of "those guys (State of Montana) are out to get us".

Section 5. The language "free of costs and deductions" can be left in this Section without consequence.

~~Section 8. We would like the effective date changed to June 1, 1989 rather than July 1, 1989 as this would affect new leases at the June, 1989 State lease sale. This is not an appropriations bill and does not require a July 1 effective date.~~

The changes that are made in this Bill are consistent with other Rocky Mountain states, and lends State Lands the benefit of being competitive with other states. As things currently stand, our regulations send another strong message that operators are not welcome in this State, as manifested by the said existing unique and onerous regulations.

TESTIMONY OF JOHN F. NORTH
Department of State Lands
House Natural Resources Committee
January 18, 1989

House Bill 133, as introduced, accomplishes four objectives. Those objectives and the Department's comments on them are:

- (1) Rentals (Sections 1 and 4) - The bill provides that rentals from any year are credited against royalties. Under current law the lessee must pay both rentals and royalties. The Department does not object to this provision. However, rentals are currently charged on producing wells in lieu of damage payments. Thus, if rentals are eliminated on producing wells, the Department must, in order to preserve school trust assets, assess damages. This will require additional site inspections.
- (2) Offset Wells (Section 3) - The bill adds to the offset well statute a provision that the lessee may drop the lease and thereby avoid the requirement to drill an offset well or pay compensatory royalties. The Department currently allows any lessee to drop any lease at any time. However, a lessee may remain civilly liable to the state for failure to protect against drainage of the state lease. The proposed language, by authorizing compensatory royalties or dropping the lease as alternative approaches, may imply that the Department may not allow the lessee to drop the lease and charge compensatory royalties for the period before the lease was dropped. The Department must have this ability to protect the school trust oil assets. The Department has therefore proposed an amendment to allow it to charge compensatory royalties up until the lease is dropped.
- (3) Delay Drilling Penalties (Sections 6 and 2) - The Department's leases are 10-year leases instead of the more common 5-year leases. Ten-year leases allow the lessees to tie up the land for speculative purposes. To compensate the trust for this speculative holding of state leases, the Legislature has required the Board of Land Commissioners to impose a delay drilling penalty, which is really an additional rental above the regular \$1.50/acre rental. The additional rental is imposed for the final 5 years of the lease term at the rate of \$1.25/acre for the sixth year and \$2.50/acre for each of the final four years of the lease term. Currently, a lessee of a state oil and gas lease can drop the lease in any year of the primary term. If the lessee wants to extend the lease past the fifth year of the primary term for drilling or speculative purposes, the lessee must pay delay drilling penalties. Delay drilling penalties encourage early exploration and development of state lands for oil and gas production and discourages the leasing of lands for purely speculative purposes.

The Department has projected that delay drilling penalties in 1994 and following years amount to about \$500,000/year.

Although it could be argued that a portion of the \$500,000 would be made up by the fact lessees would retain leases longer, revenue from delay drilling penalties would not be recouped in increased rental payments if

- (a) leases dropped because of delay drilling penalties are picked up by other lessees, or

- (b) the abolition of delay drilling penalties does not increase regular rentals by \$500,000. Said another way, the number of acres leased would have to double because a lease held for ten years with delay drilling penalties yields approximately twice (~~\$22.75~~ ^{\$22.75}/acre vs. ~~\$12.50~~ ^{\$12.50}/acre) the amount a lease held for ten years at the regular rate yields.

Although the Department has not had time to calculate what percentage of leases dropped under the delay drilling penalty system are leased again, the percentage is significant. Second, it is not likely that leased acres would double as a result of repeal of the delay drilling penalty.

I have noticed another defect of a more technical but serious nature with the bill. Under the Montana Enabling Act, the Montana Constitution, and section 77-3-402, the Board of Land Commissioners has general authority to lease state lands for oil and gas. The repeal of the delay drilling penalty statute, in my opinion, merely removes the requirement that the Board impose a delay drilling penalty. It does not remove the authority of the Board to impose a delay drilling penalty. Therefore, the title of the bill, which indicates that the "authority" to impose delay drilling penalties, is in error.

- (4) Deductions (Section 5) - The current statute provides that the lessee pay the state's royalty "free of cost or deductions." Section 5 would eliminate this provision. Its elimination would greatly increase the accounting and auditing responsibilities of the Department. The Department would therefore suggest that Section 5 be eliminated.

Finally, to avoid constitutional questions, a section should be added clarifying that this act applies only to leases entered into after the effective date of the act.

HB 133 - DEPARTMENT OF STATE LANDS' PROPOSED AMENDMENTS
House Natural Resources Committee
January 18, 1989

1. Title, line 5.
Following: "RENTALS,"
Strike: "DELAY DRILLING PENALTIES"
2. Title, lines 7 and 8.
Following: "LEASES;" on line 7
Strike: remainder of lines 7 and 8 in their entirety
3. Title, line 9.
Following: "77-3-423"
Strike: "77-3-425"
Following: "77-3-427"
Insert: "AND"
4. Title, line 10
Following: line 9
Strike: "AND 77-3-434,"
Following: "MCA;"
Strike: REPEALING SECTION 77-3-424, MCA;"
5. Page 2, line 7.
Strike: section 2 in its entirety
6. Page 3, line 6.
Following: "if"
Strike: "it"
Insert: "the board"
7. Page 3.
Following: line 11.
Insert: "(3) This section does not impair the right of the state to seek damages from an oil and gas lessee for the lessee's failure to protect the lease from drainage of oil or gas by a well adjacent to the state lease."
8. Page 3, line 17.
Following: "in"
Strike: "on"
Insert: "in"
9. Page 4, line 7.
Strike: section 5 in its entirety
10. Page 4, line 25.
Strike: section 6 in its entirety
11. Page 5.
Following: line 5
Insert: "NEW SECTION. Section 9. Applicability. This act applies to all leases entered into after the effective date of this act."
Renumber: subsequent section.

Natural Resources COMMITTEE

DATE 1-18-89

SPONSOR (Rep. Kasper)

IF YOU CARE TO WRITE COMMENTS, ASK SECRETARY FOR WITNESS STATEMENT FORM.

CS-33

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 51st LEGISLATURE - REGULAR SESSION

COMMITTEE ON NATURAL RESOURCES

Call to Order: By Chairperson Bob Raney, on January 20,
1989, at 3:04 p.m.

ROLL CALL

Members Present: All except:

Members Excused: Rep. Hannah and Rep. Harper

Members Absent: None

Staff Present: Claudia Montagne, Secretary; Hugh Zackheim,
Environmental Quality Council

Announcements/Discussion: REP. GIACOMETTO announced that
the Department of State Lands and Oil and Gas industry
representatives had met on HB 133 and have come up with
a compromise proposal that will be presented during the
hearing on Monday, January 23, 1989.

HEARING ON HB 143

Presentation and Opening Statement by Sponsor:

REP. SCHYE, District 18, opened, stating that the bill sets
up a oil and gas production damage account from the RIT
interest, \$250,000 per biennium, to be reallocated
until the fund reaches \$500,000, and increased by the
amount necessary each year to bring it up to \$500,000.
A drilling bond would still be required, but would not
be cancelled until the hole was properly plugged and
abandoned, or a producing well is established.
Operators are still required to reclaim their sites
when the producing well is plugged and abandoned; if
they do not, a lien is placed against their property.
The Board of Oil and Gas can also use this account to
reclaim old wells if the responsible party cannot be
found or if they do not have sufficient funds.

List of Testifying Proponents and What Group They Represent:

Senator Delwyn Gage, District 5

DAILY ROLL CALL

HOUSE NATURAL RESOURCES

COMMITTEE

50th LEGISLATIVE SESSION -- 1989

Date 1-26-89

NAME	PRESENT	ABSENT	EXCUSED
Rep. Bob Raney, Chairman	✓		
Rep. Ben Cohen, Vice-Chairman	✓		
Rep. Kelly Addy	✓		
Rep. Vivian Brooke	✓		
Rep. Hal Harper	✓		Exc.
Rep. Mike Kadas	✓		
Rep. Mary McDonough	✓		
Rep. Janet Moore	✓		
Rep. Mark O'Keefe	✓		
Rep. Robert Clark	✓		
Rep. Leo Giacometto	✓		
Rep. Bob Gilbert	✓		
Rep. Tom Hannah			✓
Rep. Lum Owens	✓		
Rep. Rande Roth	✓		
Rep. Clyde Smith	✓		

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 51st LEGISLATURE - REGULAR SESSION

COMMITTEE ON NATURAL RESOURCES

Call to Order: By Chairperson Bob Raney, on January 23,
1989, at 3:00 p.m.

ROLL CALL

Members Present: All except:

Members Excused: Rep. Harper

Members Absent: None

Staff Present: Claudia Montagne, Secretary; Hugh Zackheim,
Staff Researcher, Environmental Quality Council

Announcements/Discussion: None

HEARING ON HB 285

Presentation and Opening Statement by Sponsor:

REP. STEPPLER, House District 21, presented HB 285, stating that the intent of the bill was that after 20 years, dormant mineral rights would revert to the present surface owner. This was 20 years after searching for the mineral owner, or 20 years of the mineral right sitting, waiting for someone to lay claim.

REP. STEPPLER introduced amendments to the bill (EXHIBIT 1). At this time there were no taxes on mineral rights, and he stated that he felt the reference to mineral rights was not appropriate. He stated that the reversion of these mineral rights back to the landowner would occur as described in Section 5, and would follow the same procedures as quieting title to property.

List of Testifying Proponents and What Group They Represent:

None

REP. ADDY expressed a concern that with these amendments, a person with a ranch could suddenly be sitting on a coal mine instead of a ranch.

Closing by Sponsor:

REP. STEPPLER closed, reiterating the intent of the bill, which was to give ownership of minerals severed and dormant back to the surface owner so that they will have more control over their land. It is to find ownership, and if not possible, to give the first right to the surface owner.

DISPOSITION OF HB 133

Hearing 1/18/89

Motion: REP. GIACOMETTO moved the bill DO PASS.

Discussion: REP. GIACOMETTO stated that Mr. North of the Department of State Lands (DSL) and the other parties had come to an agreement and had language to that effect. He deferred to Mr. North.

MR. NORTH said that both sides had resolved the issue with proposed amendments (EXHIBIT 2). REP. BROOKE asked if there were any way that the committee could get the fiscal note, and Mr. North said that they were in the process of developing a revised fiscal note, but that he believed that the impact for the biennium would be approximately \$57,750. This represented the cost of .5 FTE starting January 1 to check leases and assess damages (salary, vehicle and benefits).

REP. KADAS asked what was the loss from not collecting delay drilling penalty, and Mr. North said that it would be \$15,000, a small enough amount to be made up with payment for land taken out of production (reimbursement for surface damages). REP. KADAS asked if this would be a general fund cost, and Mr. North said yes.

After clarification of other portions of the amendment, including the refund of the delay drilling penalty, and situations with dry holes, JANELLE FALLAN presented information on the bill and its amendments (EXHIBIT 3) and stated her support of the amendments. She stated that any increased

costs to the state were in the future, and that there would be a positive fiscal impact with leasing of additional land.

REP. GIACOMETTO asked, considering the fact that oil prices and leases of state land were down, how significant an impact would this bill have, and Ms Fallan stated that it would be significant and that more money would be made by the state.

REP. O'KEEFE asked about the recent decrease in federal rates for leasing, and if that had impacted the amount of leasing, and Ms Fallan said that she didn't know, and that it had just happened.

REP. HANNAH asked about the delay drilling penalty, and the difference in costs between the original bill and the proposed amended bill, and Ms Fallan stated that the bill as introduced had eliminated the delay drilling penalty. Now there was an additional \$1.25/acre fee for years 6 through 10 as the delay drilling penalty in addition to the lease amount. The compromise was that a developer would be refunded the delay drilling penalty for the years that he/she drilled. Regarding the costs, Mr. North said that the original fiscal impact was \$500,000 due to the loss of the delay drilling penalty, and as amended, the loss would be \$15,000.

REP. HANNAH asked if there was still incentive to producers in the bill as amended, and Ms Fallan said yes, in the removal of rental on producing wells that were paying royalty payments. She added that the royalty rate was 12.5 % and the rental was \$1-1.50/acre; these were close to rates in other states.

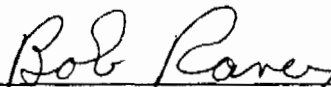
MR. NORTH presented his written statements requested by the committee regarding the issues in the bill (EXHIBIT 4).

Amendment and Votes: REP. GIACOMETTO moved to accept the amendments as proposed by Department of State Lands. The motion CARRIED with Rep. Hannah voting no.

Recommendation and Vote: There was a motion to DO PASS AS AMENDED, and the motion CARRIED unanimously.

ADJOURNMENT

Adjournment At: 4:25 p.m.



REP. BOB RANEY, Chairperson

BR/cm

1912.min

DAILY ROLL CALL

HOUSE NATURAL RESOURCES COMMITTEE

50th LEGISLATIVE SESSION -- 1989

Date 1-23-89

NAME	PRESENT	ABSENT	EXCUSED
Rep. Bob Raney, Chairman	✓		
Rep. Ben Cohen, Vice-Chairman	✓		
Rep. Kelly Addy	✓		
Rep. Vivian Brooke	✓		
Rep. Hal Harper			✓
Rep. Mike Kadas	✓		
Rep. Mary McDonough	✓		
Rep. Janet Moore	✓		
Rep. Mark O'Keefe	✓		
Rep. Robert Clark	✓		
Rep. Leo Giacometto	✓		
Rep. Bob Gilbert	✓		
Rep. Tom Hannah			
Rep. Lum Owens	✓		
Rep. Rande Roth	✓		
Rep. Clyde Smith	✓		

2
DATE 1-23-89
HB 133

HB 133 - PROPOSED AMENDMENTS

1. Title, line 7.
Following: "LEASES;"
Strike: remainder of line 7 and line 8
Insert: "PROVIDING FOR REFUND OF DELAY DRILLING PENALTIES FOR YEARS IN WHICH DRILLING OCCURS;"
2. Title, line 10.
Following: "77-3-434, MCA;"
Strike: REPEALING SECTION 77-3-424, MCA;"
3. Title, line 11.
Following: "PROVIDING"
Insert: "AN APPLICABILITY DATE AND"
4. Page 2, lines 18 and 19.
Strike: "continues to pay an annual rental as set forth in 77-3-423"
Insert: "resumes payment of any delay drilling penalties imposed by the board. Upon the resumption of payment of any required delay drilling penalties and their continued payment, the lease continues in force during the primary term as though there had been no interruption in the delay drilling penalty payments."
5. Page 3, line 6.
Following: "if"
Strike: "it"
Insert: "the board"
6. Page 3.
Following: line 11.
Insert: "(3) If the board or the lessee terminates the lease, that termination does not impair any implied covenant against drainage or the right of the board to seek damages from the lessee for the lessee's failure to protect the lease from drainage of oil or gas by a well adjacent to the state lease."
7. Page 3, line 17.
Following: "in"
Strike: "on"
Insert: "in"
8. Page 4, line 7.
Strike: section 5 in its entirety
9. Page 4, line 25.
Strike: section 6 in its entirety
10. Page 5.
Following: line 1
Insert: SECTION 5. Section 77-3-424 is amended to read:

77-3-424. Power to terminate lease in absence of commencement of drilling or payment of delay drilling penalty. (1) In every oil and gas lease

granted after March 3, 1955, under this part there ~~shall~~ must be reserved to the board full power to declare termination of the lease at the end of the fifth year or any subsequent year of the primary term of the lease upon failure of the lessee to either:

(a) commence the drilling of a well for oil and gas upon the leased premises; or

(b) pay a delay drilling penalty as follows:

(i) for the sixth year of the lease \$1.25 per acre per year; and

(ii) for the remainder of the primary term of the lease an amount per acre per year as the board may in its discretion determine.

(2) Notice of that determination ~~shall~~ must be given to the lessee, and if the lessee applies for a hearing thereon within 10 days after receipt of the notice, the determination ~~shall-become~~ becomes final only after such hearing has been held.

(3) This annual delay drilling penalty ~~shall~~ must be paid each year in advance. The board shall refund delay drilling penalties paid on a lease for any year in which the lessee commences drilling on that lease.

(4) If a well for oil and gas is commenced, the drilling of the well ~~shall~~ must be prosecuted with due diligence and dispatch to such depth as is necessary to make a reasonable test for oil and gas.

Renumber: subsequent section

11. Page 5.

Following: line 5

Insert: "NEW SECTION. Section 7. Applicability. This act applies to all leases entered into after the effective date of this act."

Renumber: subsequent section.

-End-



MONTANA PETROLEUM ASSOCIATION

A Division of the

Rocky Mountain Oil and Gas Association

Helena Office
2030 11th Avenue, Suite 23
Helena, Montana 59601
(406) 442-7582

Janelle K. Fallan
Executive Director

EXHIBIT

DATE

1-23-89

FILE

HB

133

HB

Billings Office
The Grand Building, Suite 510
P.O. Box 1398
Billings, Montana 59103
(406) 252-3871

HB 133

with amendments as agreed to between the Montana Petroleum Association and the Montana Department of State Lands

January 23, 1989

HB 133 amends the law governing leasing of state oil and gas acreage and covers three issues:

- I. Rental on royalty (77-3-423)
- II. Delay drilling penalties (77-3-424)
- III. Offset wells vs. compensatory royalties vs. dropping the lease (77-3-427)

Lessor The one who sells the lease to the minerals. May also be referred to as the mineral owner. In this discussion the state is the lessor.

Lessee The one who buys the lease. Also referred to as the operator or producer.

I. Rental on royalty

Also known as "delay rental," rentals are paid by the lessee to the lessor for the privilege of deferring drilling operations during the primary term of the lease. Montana lease rentals are \$1.50 per acre. Federal rates on many existing leases were just decreased from \$2-\$3 per acre to \$1.

Once production is established, the lessor receives a royalty and the reason for the rental has been eliminated. The states charges a royalty is 13% on oil and 12% on gas.

(A royalty is the mineral owner's share of the production. The lessor assumes no risk and does not invest in the exploration for and production of the minerals. For the privilege of taking the risk and making the investment, the lessee pays the mineral owner a royalty that is usually 1/8 of the value of the production. While the royalty owner does not share in costs of production, he or she does share in the taxes. Producers usually deduct the lessor's share of the production taxes (net proceeds, severance, RIT, conservation) from the royalty payment.)

Montana charges a rental on lands that are producing oil or gas and therefore paying the state a royalty. The state has done

this rather than charge operators for surface damages. However, payment of surface damages as compensation for land taken out of production (e.g. grazing or cropland) and restoration of the surface (e.g. returning a road or well area to its original condition) are standard operating procedure in the petroleum industry and are required by state law. HB 133 includes no new charge to the state to inspect its surface.

Montana is the only Rocky Mountain state charging rental in addition to royalty. Eliminating it will do much to improve the state's competitiveness with other states.

II. Delay drilling penalty

The delay drilling penalty is also unique to Montana. It is an additional rental of \$1.25 per acre paid in years 6-10 of the state lease if a well is not drilled.

The rental and delay drilling penalty are paid a year in advance. Therefore, the full year's penalty is assessed even if a well is drilled during the year.

The agreed-to amendment leaves the delay drilling penalty in place, but provides for a refund during the year that a well is drilled.

III. Offset wells

An offset well is one drilled on one tract of land to prevent oil or gas from being drained from that tract by a well on an adjoining tract.

If the lessee agrees with the lessor that the lessor's oil or gas is being drained, the lessee may pay a compensatory royalty or drill an offset well so that the lessor receives an actual royalty. The state lease specifically obligates a lessee to develop proven or probable reserves from an offsetting contiguous reservoir.

The proposed amendment allows the lessee to drop the lease if the lease does not warrant further activity. HB 133 puts the state in the same position as private landowners -- the state must demonstrate that its lease is being drained.

The amendment proposed by DSL, to further clarify its right to protect its interests, is probably unnecessary but is not expected to create problems. Industry is not attempting to avoid payment of compensatory damages when they indeed are due the state.

If the state is concerned that its lands are being drained, there are many ways to monitor lands and wells. DSL currently receives information on wells being drilled, division orders on producing wells and monthly statements for production, price and volume sold. The Montana Oil Journal lists all new wells,

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locations, completion and drilling progress every week for \$26.00 *HB 133* per year. Petroleum Information provides similar information with more detail for \$1080 per year.

The Board of Oil and Gas Conservation also has maps and well information. Numerous other private companies provide well information in a variety of forms. Operators use these media to monitor well activity, to help learn where good drilling prospects are, and also to see if any drilling activity may affect their own leaseholdings. It is not a time-consuming process if done regularly, but private companies generally assume watching out for their own interest is a vital part of their operation.

In fact, the entire issue raised by 77-3-427 is an infrequent occurrence.

* * *

HB 133 will not apply to any leases now in effect. Therefore, any negative fiscal impacts (such as increased costs) will not occur until some point in the future, and will be phased in gradually, as pre-HB 133 leases are dropped and new leases are taken. Positive fiscal impacts resulting from increased interest in state leases will be realized as soon as the new lease is in effect.

While the decline in the price of oil has undoubtedly been the major cause of the decline of state leasing, other factors must be considered. The price of oil is down 40% since 1984, but measures of interest in state lands are down more: the number of acres under lease is down 60%, oil royalties are down 56%, rentals are down 59% and bonuses are down 96%.

(A bonus is the cash consideration paid by the lessee to the mineral owner for the execution of the oil and gas lease. Bonuses on state leases are decided at public auction.)

The price of oil has fallen just as much in North Dakota as in Montana. Acres sold in 1988 in North Dakota are down 64% from 1985; the comparable figure for Montana is 75%. While Montana's bonus payments have fallen 96% from 1984 to 1988, North Dakota's have fallen 85%. Hence, a decrease in state leasing is to be expected, but Montana's noncompetitive lease has worsened the problem here.

HOUSE BILL HB 133

SECTIONS 1 AND 5

At the hearing on Wednesday, January 18, sections 1 and 5 were not in contention. The Department had agreed to section 1 and the industry had agreed to drop section 5.

SECTION 3

The controversy surrounded sections 3 and 4. Subsection (1) of 77-3-427 currently provides that when someone drills a well adjacent to a state section that is leased for oil and gas and that well drains oil or gas from under the state section, the state lessee must immediately drill a well on the state section to prevent the state's oil from being drained. This well is called an "offset well." Subsection (2) of 77-3-427 provides that the state may allow the lessee, as an alternative to drilling an offset well, pay the state for the oil lost. These payments are called "compensatory royalties."

This compensatory royalty provision applies only after the Board formally requires payment of compensatory royalties. It does not apply to drainage that occurs before the state discovers that its lease is being drained. When the state discovers a lease has been significantly drained and that the lessee should have known about the drainage and prevented it by drilling an offset well (or paid compensatory royalties), the state may demand and sue for payment of damages.

Section 3 amends 77-3-427(2) to authorize the state to allow the lessee to release - that is, to drop - the lease instead of drilling an offset well or paying compensatory royalties. In practice, the state always has allowed the lessee to drop the lease at the end of any year. The state therefore has no problem with section 3 so long as it is not read to remove the ability of the state to demand and sue for damages due to drainage that occurred before lease cancellation. The state is concerned, however, that the amendment to section 3 specifically authorizing the lessee to drop the lease as an alternative to drilling an offset well might be construed as a waiver of the state's right to damages for drainage because that right arises out of the lessee's duty to drill an offset well. The state therefore proposed at the hearing that the committee add to section 3 an amendment specifically stating that the state does not waive its right to seek damages for drainage.

This amendment was the cause of the controversy at the hearing. Industry representatives and the state have now agreed to propose this amendment in a slightly modified form.

SECTION 4

State oil and gas leases are for a term of ten years. Most private, federal, and leases of other states are for five years. The ten year term allows the lessee to speculate in state leases, that is, to tie up the state tract for ten years without drilling. To gain compensation for this speculation, the state has imposed additional rentals for any of the final five years of the lease term in which the lessee is not drilling or operating a well on the lease. These additional rentals are called "delay drilling penalties." At

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the hearing, industry representatives contended that the delay drilling penalties make state leases unattractive to the industry after the fifth year and that the state should eliminate them. They maintained that dropping delay drilling penalties will result in more state acres being leased and an increased return to the school trust. The state contended that abolishing delay drilling penalties would amount to a loss in revenue of at least \$500,000 in 1994 and following years.

The state and industry representatives have now agreed to retain delay drilling penalties but to provide for their refund for any year in which the lessee commences drilling. Delay drilling penalties are paid in advance.

STANDING COMMITTEE REPORT

January 25, 1989

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Mr. Speaker: We, the committee on Natural Resources report that House Bill 133 (first reading copy -- white) do pass as amended.

Signed: _____
Bob Raney, Chairman

And, that such amendments read:

1. Title, lines 7 and 8.

Following: "LEASES;"

Strike: remainder of lines 7 and 8 in their entirety

Insert: "PROVIDING FOR REFUND OF DELAY DRILLING PENALTIES FOR YEARS IN WHICH DRILLING OCCURS;"

2. Title, line 9.

Following: "77-3-423,"

Insert: "77-3-424,"

Following: "77-3-427,"

Insert: "AND"

Following: "77-3-432,"

Insert: "MCA;"

3. Title, line 10.

Strike: "AND 77-3-434," through "77-3-424, MCA;"

4. Title, line 11.

Following: "PROVIDING"

Insert: "AN APPLICABILITY DATE AND"

5. Page 2, lines 18 and 19.

Strike: "continues to pay an annual rental as set forth in 77-3-423"

Insert: "resumes payment of any delay drilling penalties imposed by the board. Upon the resumption of payment of any required delay drilling penalties and their continued payment, the lease continues in force during the primary term as though there had been no interruption in the delay drilling penalty payments"

6. Page 3, line 6.
Following: "if"
Strike: "it"
Insert: "the board"

7. Page 3, line 11.
Following: "otherwise."
Insert: "(3) If the board or the lessee terminates the lease,
that termination does not impair any implied covenant
against drainage or the right of the board to seek damages
from the lessee for the lessee's failure to protect the
lease from drainage of oil or gas by a well adjacent to the
state lease."

8. Page 3, line 17.
Following: "in"
Strike: "on"
Insert: "in"

9. Page 4, line 7 through page 5, line 1.
Strike: sections 5 and 6 in their entirety
Insert:

"SECTION 5. Section 77-3-424, MCA, is amended to read:

"77-3-424. Power to terminate lease in absence of
commencement of drilling or payment of delay drilling penalty.
(1) In every oil and gas lease granted after March 3, 1955,
under this part there ~~shall~~ must be reserved to the board full
power to declare termination of the lease at the end of the fifth
year or any subsequent year of the primary term of the lease upon
failure of the lessee to either:

(a) commence the drilling of a well for oil and gas upon the
leased premises; or

(b) pay a delay drilling penalty as follows:

(i) for the sixth year of the lease \$1.25 per acre per year;
and

(ii) for the remainder of the primary term of the lease an
amount per acre per year as the board may in its discretion
determine.

(2) Notice of that determination ~~shall~~ must be given to the
lessee, and if the lessee applies for a hearing thereon within 10
days after receipt of the notice, the determination ~~shall become~~
becomes final only after ~~such~~ the hearing has been held.

(3) This annual delay drilling penalty ~~shall~~ must be paid
each year in advance. The board shall refund delay drilling
penalties paid on a lease for any year in which the lessee
commences drilling on that lease.

January 25, 1989
Page 3 of 3

(4) If a well for oil and gas is commenced, the drilling of the well ~~shall~~ must be prosecuted with due diligence and dispatch to such depth as is necessary to make a reasonable test for oil and gas."

Renumber: subsequent sections

10. Page 5.

Following: line 5

Insert: "NEW SECTION. Section 7. Applicability. This act applies to all leases entered into after [the effective date of this act]."

Renumber: subsequent section.

-End-

CHAIRMAN--TOM KEATING
SECRETARY--HELEN McDONALD
NORMAL SCHEDULE==> SITE: ROOM 405

COMMITTEE--(S) NATURAL RESOURCES
DAYS: M,W,F TIME: 1:00 P.M.

OFFICE--

REFER		NOTE: BILL WILL BE LISTED TWICE IF REREFERRED BACK TO THE SAME COMMITTEE
BILL	DATE == LATEST DATE/ACTION ON BILL	=====
	SPONSOR: STORY, PETER	TITLE-STUDY SOLID WASTE REGULATION
SJ 24	04/17 04/28--(H) SIGNED BY SPEAKER SPONSOR: RAPP-SVRCEK, PAUL	TITLE-JOINT RESOLUTION ASKING IDAHO TO REVISE RESTRICTIONS ON LOG EXPORTS
HB 82	01/23 02/15--(S) CHAPTER NUMBER SPONSOR: O'KEEFE, MARK	EFFECTIVE DATE: 02/15/89 TITLE-DESIGNATE ARBOR DAY AS OFFICIAL DAY OF OBSERVANCE IN MONTANA
HB 133	02/06 03/20--(H) CHAPTER NUMBER SPONSOR: HAYNE, HARRIET	EFFECTIVE DATE: 07/01/89 TITLE-GENERALLY REVISE LAWS RELATING TO STATE OIL AND GAS LEASE PAYMENTS
HB 143 A	03/22 04/14--(H) CHAPTER NUMBER SPONSOR: SCHYE, TED	EFFECTIVE DATE: 07/01/89 TITLE-OIL AND GAS WELL PLUGGING COSTS PAID FROM RITT INTEREST
HB 172	01/30 03/24--(H) CHAPTER NUMBER SPONSOR: SWIFT, BERNIE	EFFECTIVE DATE: 10/01/89 TITLE-CRIME TO PUT SUBSTANCE INTO TREE OR WOOD TO HARM LOGGING OR OTHER EQUIPMENT
HB 274	02/10 04/05--(H) CHAPTER NUMBER SPONSOR: QUILICI, JOE	EFFECTIVE DATE: 10/01/89 TITLE-AUTHORIZING DSL TO INVESTIGATE USE OF EXPLOSIVES RELATED TO HARD-ROCK MINING
HB 327	02/14 03/23--(H) CHAPTER NUMBER SPONSOR: GIACOMETTO, LEO	EFFECTIVE DATE: 03/23/89 TITLE-EXTEND PRIMARY TERM OF STATE OIL AND GAS LEASES AFFECTED BY LITIGATION
HB 362	02/06 03/23--(H) CHAPTER NUMBER SPONSOR: BROWN, DAVE	EFFECTIVE DATE: 10/01/89 TITLE-ALLOW STATE TO ACCEPT FEDERALLY CONDEMNED LAND
HB 482	02/28 03/24--(H) CHAPTER NUMBER SPONSOR: COCCHIARELLA, VICKI	EFFECTIVE DATE: 10/01/89 TITLE-ALLOW LOCAL REVIEW OF PUBLIC NONCOMMUNITY WATER AND SEWER SYSTEMS
HB 486	02/28 04/27--(H) TRANSMITTED TO GOVERNOR SPONSOR: GRADY, ED	TITLE-REQUIRE GROUNDWATER MONITORING AT CERTAIN LANDFILLS AND WASTE DISPOSAL SITES
HB 540	02/28 03/22--(H) CHAPTER NUMBER SPONSOR: RANEY, BOB	EFFECTIVE DATE: 10/01/89 TITLE-REQUIRES DHES APPROVAL OF WATER SUPPLY AND SEWAGE PLANS BEFORE CONSTRUCTION
HB 581	02/28 03/14--(H) CHAPTER NUMBER SPONSOR: IVERSON, DENNIS	EFFECTIVE DATE: 10/01/89 TITLE-REVISE HARD-ROCK MINING ACT
HB 657 R	02/28 04/12--(H) CHAPTER NUMBER SPONSOR: OWENS, LUM	EFFECTIVE DATE: 07/01/89 TITLE-REVISE FIRE HAZARD REDUCTION LAW
HB 672	02/28 03/20--(S) ADVERSE COM RPT ADOPTED (S) NATURAL RESOURCES SPONSOR: COHEN, BEN	TITLE-RESTRICTING EXEMPTION FROM SOLID WASTE DISPOSAL REGULATIONS TO INDIVIDUALS
HB 676 R	03/31 04/14--(S) 2ND READ INDEFINITE POSTPONED SPONSOR: RANEY, BOB	TITLE-INFECTIOUS WASTE MANAGEMENT ACT
HB 678	02/28 04/03--(H) CHAPTER NUMBER SPONSOR: GILBERT, BOB	EFFECTIVE DATE: 01/01/90 TITLE-PROVIDING FOR NOTIFICATION AND CONSULTATION BEFORE PRIVATE FOREST PRACTICES
HB 679	02/28 03/27--(H) CHAPTER NUMBER SPONSOR: GRADY, ED	EFFECTIVE DATE: 07/01/89 TITLE-REDUCES SMALL MINER EXEMPTION TO 2 ACRES FOR PLACER OR DREDGE OPERATIONS
HB 680	02/28 03/27--(H) CHAPTER NUMBER SPONSOR: GRADY, ED	EFFECTIVE DATE: 07/01/89 TITLE-REQUIRES MINERS TO OBTAIN OPERATING PERMIT FOR CYANIDE ORE-PROCESSING AREA

HOUSE BILL NO. 133

INTRODUCED BY HAYNE, IVERSON, D. BROWN, GILBERT, KEATING,
REHBERG, GAGE, MEYER, ABRAMS, TVEIT, GERVAIS

A BILL FOR AN ACT ENTITLED: "AN ACT GENERALLY REVISING LAWS
RELATING TO PAYMENT OF RENTALS, DELAY DRILLING PENALTIES,
COMPENSATORY ROYALTIES, AND ROYALTIES ON STATE OIL AND GAS
LEASES; ~~ELIMINATING AUTHORITY TO TERMINATE LEASES IN THE~~
~~ABSENCE OF DRILLING OR PAYMENT OF DELAY DRILLING PENALTIES;~~
PROVIDING FOR REFUND OF DELAY DRILLING PENALTIES FOR YEARS
IN WHICH DRILLING OCCURS; AMENDING SECTIONS 77-3-423,
THROUGH 77-3-425, 77-3-427, AND 77-3-432, AND 77-3-434, MCA;
~~REPEALING SECTION 77-3-424, MCA; AND PROVIDING AN EFFECTIVE~~
DATE AND AN APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 77-3-423, MCA, is amended to read:

"77-3-423. Annual rental. (1) The annual money rentals
to be paid to the state for oil and gas leases issued on and
after July 1, 1975, shall be set by the board but may not be
less than \$1.50 for each acre of land leased.

(2) In addition to the sum of \$1.50 per acre, the
rental for the first year of the lease shall also include
any sum in excess of \$1.50 per acre offered and accepted for
the first year's rental.

(3) This annual rental shall in no case be less than
\$100 a year.

(4) The first year's rental shall be paid before the
issuance of the lease. The rentals for each subsequent year
of the lease shall be due and payable before the beginning
of such subsequent year, and upon failure to make such
payment, the lease terminates unless there is a producing
well on the lease. Rental paid for any year shall be
credited against any royalty that accrues during that year."

Section 2. Section 77-3-425, MCA, is amended to read:

"77-3-425. Dry hole clause. If the first well drilled
is a dry hole and if a second well is not commenced on the
land covered by the lease before the next anniversary of the
lease following the completion of the well, the lease may be
terminated by the board unless the lessee, on or before such
anniversary, ~~resumes the payments of penalties in the~~
~~amounts provided in 77-3-424. Upon the resumption of the~~
~~payment of such delay drilling penalties and their continued~~
~~payment, the lease continues in force during the primary~~
~~term as though there had been no interruption in the delay~~
~~drilling penalty payments continues to pay an annual rental~~
as set forth in 77-3-423 RESUMES PAYMENT OF ANY DELAY
DRILLING PENALTIES IMPOSED BY THE BOARD. UPON THE
RESUMPTION OF PAYMENT OF ANY REQUIRED DELAY DRILLING
PENALTIES AND THEIR CONTINUED PAYMENT, THE LEASE CONTINUES

1 IN FORCE DURING THE PRIMARY TERM AS THOUGH THERE HAD BEEN NO
 2 INTERRUPTION IN THE DELAY DRILLING PENALTY PAYMENTS."

3 **Section 3.** Section 77-3-427, MCA, is amended to read:

4 "77-3-427. Provision for offset wells -- compensatory
 5 royalties. (1) Oil and gas leases granted by the state shall
 6 contain suitable provisions imposing upon all lessees the
 7 obligation to drill offset wells wherever and whenever
 8 necessary to prevent waste and damage to the property of the
 9 state.

10 (2) The board may allow the lessee the option of
 11 following options in lieu of drilling an offset well:

12 (a) releasing the lands in question; or

13 (b) paying a compensatory royalty on a nonproducing
 14 lease in--lieu--of--drilling-an-offset-well if it THE BOARD
 15 determines that such compensatory royalty will fully
 16 compensate the state for waste and damage to the property of
 17 the state. The compensatory royalty shall be based upon the
 18 estimated drainage, as determined by the board, and shall be
 19 paid on a monthly basis unless circumstances require
 20 otherwise.

21 (3) IF THE BOARD OR THE LESSEE TERMINATES THE LEASE,
 22 THAT TERMINATION DOES NOT IMPAIR ANY IMPLIED COVENANT
 23 AGAINST DRAINAGE OR THE RIGHT OF THE BOARD TO SEEK DAMAGES
 24 FROM THE LESSEE FOR THE LESSEE'S FAILURE TO PROTECT THE
 25 LEASE FROM DRAINAGE OF OIL OR GAS BY A WELL ADJACENT TO THE

1 STATE LEASE."

2 **Section 4.** Section 77-3-432, MCA, is amended to read:

3 "77-3-432. Royalty. In every oil and gas lease granted
 4 by the state under this part and acts amendatory thereto,
 5 there shall be reserved to the state as consideration
 6 therefor---in--addition--to--the--rentals--as--hereinbefore
 7 provided, a royalty in on IN all oil and gas produced and
 8 saved from all lands covered thereby and not used for light,
 9 fuel, and operation purposes on the leased premises, which
 10 shall be equivalent to the full market value, as ascertained
 11 by the board at the date of such lease, of the estate or
 12 interest of the state in the lands and oil and gas deposits
 13 disposed of under such lease. Such royalty reservation shall
 14 be set by the board but may not be less than 12 1/2% on gas
 15 and not less than 12 1/2% on that portion of the average
 16 production of oil or casinghead gasoline for each producing
 17 well not exceeding 3,000 barrels for the calendar month. The
 18 state may share the expense of transporting the oil to the
 19 nearest market on a basis proportional to the state's
 20 royalty interest in such oil and at a rate per mile
 21 acceptable to the department."

22 ~~Section 5. Section 77-3-434, MCA, is amended to read:~~

23 ~~"77-3-434. Manner of making royalty payment: Such A~~
 24 ~~lease shall provide for the rendering of payment of such the~~
 25 ~~royalty on all oil and gas produced and saved and sold or~~

1 used--off--the-premises-in-the-following-manner-and-upon-the
2 following-terms:

3 (1)--the-lessee-shall-pay-to-the-state-in-cash, for all
4 oil--and--gas--royalty--reserved,--the--posted--field--price
5 existing-on-the-day-such-oil-or-gas-is-run-into-any-pipeline
6 or--storage-tank-to-the-credit-of-the-lessee, plus any bonus
7 actually-paid-or-agreed-to-be-paid-to-the--lessee--for--such
8 oil-or-gas; or

9 (2)--at--the--option-of-the-state, exercised-in-writing
10 by-the-board-not-oftener more-frequently than-every-30-days,
11 the-lessee-shall-deliver-the-state's-royalty-oil-or-gas free
12 of-cost-or-deductions into-the-pipeline-to-which--the--wells
13 of---the--lessee--may--be--connected--or--into--any--storage
14 designated-by-the-state-and-connected-with-such-wells.*

15 NEW-SECTION. Section 6. Repealer. Section 77-3-424,
16 MCA, is repealed.

17 SECTION 5. SECTION 77-3-424, MCA, IS AMENDED TO READ:

18 "77-3-424. Power to terminate lease in absence of
19 commencement of drilling or payment of delay drilling
20 penalty. (1) In every oil and gas lease granted after March
21 3, 1955, under this part there shall must be reserved to the
22 board full power to declare termination of the lease at the
23 end of the fifth year or any subsequent year of the primary
24 term of the lease upon failure of the lessee to either:

25 (a) commence the drilling of a well for oil and gas

1 upon the leased premises; or

2 (b) pay a delay drilling penalty as follows:

3 (i) for the sixth year of the lease \$1.25 per acre per
4 year; and

5 (ii) for the remainder of the primary term of the lease
6 an amount per acre per year as the board may in its
7 discretion determine.

8 (2) Notice of that determination shall must be given
9 to the lessee, and if the lessee applies for a hearing
10 thereon within 10 days after receipt of the notice, the
11 determination shall-become becomes final only after such the
12 hearing has been held.

13 (3) This annual delay drilling penalty shall must be
14 paid each year in advance. The board shall refund delay
15 drilling penalties paid on a lease for any year in which the
16 lessee commences drilling on that lease.

17 (4) If a well for oil and gas is commenced, the
18 drilling of the well shall must be prosecuted with due
19 diligence and dispatch to such depth as is necessary to make
20 a reasonable test for oil or gas."

21 NEW SECTION. Section 6. Extension of authority. Any
22 existing authority to make rules on the subject of the
23 provisions of [this act] is extended to the provisions of
24 [this act].

25 NEW SECTION. SECTION 7. APPLICABILITY. [THIS ACT]

HB 0133/02

1 APPLIES TO ALL LEASES ENTERED INTO AFTER [THE EFFECTIVE DATE
2 OF THIS ACT].

3 NEW SECTION. Section 8. Effective date. [This act] is
4 effective July 1, 1989.

-End-

MINUTES

MONTANA SENATE 51st LEGISLATURE - REGULAR SESSION

COMMITTEE ON NATURAL RESOURCES

Call to Order: By Thomas Keating, on March 3, 1989,
at 1:00 p.m. in Room 405 of the State Capitol.

ROLL CALL

Members Present: Senators: Thomas Keating, Chairman,
Larry Tveit, Fred Van Valkenburg, Loren Jenkins,
Lawrence Stimatz, Pete Story, Bill Yellowtail,
Elmer Severson, Cecil Weeding, Dorothy Eck and
Jerry Noble.

Members Excused: None

Members Absent: Senator Darryl Meyer

Staff Present: Bob Thompson and Helen McDonald

HEARING ON HB 362

Presentation and Opening Statement by Sponsor:

Representative Dave Brown, House District #72, Butte-Silver Bow, introduced this bill. This bill comes under the Federal Emergency Management Agency (FEMA) regulations, which are a result of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). The state and federal governments are seeking to work together to identify and eliminate hazardous waste contamination. In some instances some properties must be condemned in order to begin the reclamation. The Department of State Lands (DLS) currently does not have condemnation authority so the federal government has used its power to condemn properties identified in Montana as being a hazardous waste contamination. The federal government requires that the state must accept title to the lands condemned.

Because of current language in Section 77-1-211, the state cannot accept title to the lands unless there is specific legislative approval. This prohibition caused a substantial problem in attempting to clean up Mill Creek in Deer Lodge County where property was identified as having hazardous waste contamination because of the Anaconda Smelter. Subsequently the

SENATE COMMITTEE ON NATURAL RESOURCES

March 3, 1989

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doesn't place any mandatory duty on the state. Should federal law be changed or a few federal court cases come down that would somehow suggest the state would be liable in such a transfer, the state would not accept the property even though the state now has the legal ability to do so.

Senator Van Valkenburg was concerned that the state might already have it and if this changes, for whatever reasons, somebody may look at the State of Montana as a deep pocket.

Tom Eggert said the the state would never become the final depository of property as the department would only act as an intermediary. DHES doesn't want to hold contaminated property because it would not be in the state's best interest. All DHES is doing is acting as an intermediary allowing property to be passed through to parties that are responsible for the contamination.

Representative Brown commented that the bill puts the state in an intermediary role, as it would be a very quick transfer. The state won't hold the property for any length of time. The difficulty with the Superfund law is that you can't do the clean up without the transfer to the state.

Senator Jenkins asked if the federal government condemns the land why can't it turn it over to the other party instead of involving the state?

Senator Brown said that question was asked of EPA and the Department of Justice. They provided the legislature with statutory rationale. The federal government is unable to transfer land directly to private persons, corporations, or partnerships.

Senator Keating asked if the USA is precluded from assigning or transferring property directly to a citizen.

Tom Eggert said that was correct.

Closing by Sponsor: Representative Brown closed by mentioning on the last line on the fourth page, the effective date would to be on passage and approval.

DISPOSITION OF HB 362

Discussion: Hearing was closed on HB 362

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SENATE COMMITTEE ON NATURAL RESOURCES

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Presentation and Opening Statement by Sponsor:

Representative Harriet Hayne, District #10, submitted opening statement. (Exhibit #3)

List of Testifying Proponents and What Group they Represent:

Janelle Fallon, Montana Petroleum Association

Doug Abelin, Montana Oil and Gas

Gary Willis, Montana Power Company

John North, Department of State Lands

List of Testifying Opponents and What Group They Represent:

None

Testimony:

John North, DSL, submitted written testimony. (Exhibit 5)

Janelle Fallon, Montana Petroleum Assn., submitted written testimony from Jack E. King, President, Montana Petroleum Association. (Exhibit 4)

Doug Abelin, Montana Oil and Gas Association, stated there are a lot of small oil wells in his area and he feels that what little this bill does would be a large benefit.

Gary Willis, Montana Power Company, stated the company leases both state leases and fee leases which are the landowner leases. The state leases pay rental in addition to royalty, which isn't usually the case with fee leases, so it supports the bill.

John North, DSL, submitted written testimony. (Exhibit 5)

Questions From Committee Members: Senator Tveit wondered if this bill passes, and regarding delay rentals, would DSL come in and assess damages instead of paying rental on the property that is disturbed.

John North said that particular provision would require the delayed drilling penalty but the actual elimination of rentals follows the lease that is producing. The state uses those payments in lieu of damage payments.

Closing by Sponsor: Representative Hayne closed by saying new production in the oil and gas fields on state lands is the main purpose of this bill. The petroleum industry in Montana paid nearly a 108 million dollars in state taxes, local taxes, and royalties in 1987. From the perspective of local government, one 50 barrel

per day oil well will generate as much local property tax as 6,240 cows, 7,900 grazing acres or 11,773 acres of tillable land. The oil well is a very good way to raise income for local government.

DISPOSITION OF HB 133

Discussion: Hearing is closed.

HEARING ON HB 172

Presentation and Opening Statement by Sponsor:

Representative Bernie Swift, District #64, introduced this bill to solve some of the "spiking" problems the logging industry has had since 1985. Spiking means placing metal or some other hard object into trees that would damage saws or manufacturing equipment. Representative Swift recalled a situation in the West Fork District where at least a dozen or more trees were "spiked". It is very difficult to find when or where this occurs. At the time this particular incident occurred, people in lumber jobs were being vandalized by having nails jammed in their tires. In 1986 on a sale in the Flathead National forest, the industry had to adjust the contract areas that were spiked and go in with metal detectors before processing those trees into logs. The cost was twenty to thirty thousand dollars. From 1986 into 1988 Champion International experienced spiked trees. In addition, dirt has been placed in crank cases in spouts of heavy equipment, dozers, etc.

The most recent incident was in November 1988 when five dozers crank cases were drained. The company lost three engines that amounted to twenty-five or thirty thousand dollars. Now that in itself is damaging and costly but the other part of it is when spiked logs are processed and they hit a band saw 40 or 50 feet long with teeth. When spiked trees hit a saw, it is just like a bullet exploding and that can cause serious injuries to workers. Representative Swift wants to deter this activity.

List of Testifying Proponents and What Group they Represent:

Tucker Hill, Champion International
Bud Clinch, Montana Loggers Association
Jim Jensen, Montana Environmental Information Center
Don Allen, Montana Wood Products Association

SENATE COMMITTEE ON NATURAL RESOURCES

March 3, 1989

Page 11 of 12

the deeds were signed and handed across the table at the same time.

Senator Eck said in regard to the problems of the superfund sites, is there a possibility of someone buying the land with a written agreement and not accepting the liability.

Senator Stimatz said that liability would be attached to the land and somebody has to clean it up. You are fool if you buy the land from somebody who says he is the responsible party because you'll learn very quickly they slipped out and you're it.

Senator Eck asked if that meant that Dennis Washington has all the liability in this situation.

Senator Stimatz said Denny Washington has some liability but who is responsible for how much will take the EPA 15 years to decide.

Senator Eck wondered if the state was liable for cleanup if the land was only owned by the state for 10 minutes.

Senator Stimatz said no, but he didn't know what the procedures are.

Senator Weeding wondered if the State of Montana was just being a conduit in this case.

Senator Stimatz said the transaction would have to take place in a short length of time. The Mill Creek transaction was instantaneous.

Senator Van Valkenburg said he is going to vote for this bill but he wanted to have this discussion on the floor of the Senate.

Senator Van Valkenburg moved that HB 362 be passed as amended. Motion carried.

HB 133 Senator Keating wants to let the wood products people sit on their bill for a couple of days to think about it. Senator Keating said he will hold off on HB 172 until another meeting.

Senator Keating said there was no opposition to HB 133 which was Representative Haynes bill.

Senator Jenkins moved HB 133 be concurred. Motion carried unanimously.

Adjournment At: 2:10 p.m.

ROLL CALL

NATURAL RESOURCES

COMMITTEE

50~~st~~ LEGISLATIVE SESSION -- 1989

Date 2-3-89

NAME	PRESENT	ABSENT	EXCUSED
Chairman Tom Keating	✓		
Vice-Chairman Larry Tveit	✓		
Senator Fred VanValkenburg	✓		
Senator Loren Jenkins	✓		
Senator Darryl Meyer		✓	
Senator Lawrence Stimatz	✓		
Senator Pete Story	✓		
Senator Bill Yellowtail	✓		
Senator Elmer Severson	✓		
Senator Cecil Weeding	✓		
Senator Dorothy Eck	✓		
Senator Jerry Noble	✓		

Each day attach to minutes.

SENATE NATURAL RESOURCES

EXHIBIT NO. 3

Mr. Chairman, for the record I am Rep. Harriet Hayne, House District 10, most of Pondera County and part of Glacier County. ~~Bill No.~~ 3-3-84 HB # 133

Mr. Chairman and members of the Committee, I bring you HB 133.

HB 133 is intended to deal with an area of state law in which Montana operates differently than other states, and in so doing, to improve revenues to education and state and local governments.

The purpose of state lands is to generate income for the schools. That is why the Enabling Act set up the permanent school trust fund and dedicated sections 16 and 36 of each survey township to that fund. As you may know, 95 per cent of royalties from state lands go to the constitutional permanent school trust and 95 percent of all rentals are divided among the schools, under Article X of the Montana Constitution.

The state owns more than six million acres in Montana, about 7 per cent of the state. One way it realizes income from these lands is to lease the underlying minerals.

Oil and gas leases on state minerals are sold at auction four times a year. The sale produces at least two forms of income for the state -- the bonus bid, and an annual rental. In FY 1987, bonus payments totaled \$179,449. The annual rentals, of \$1.50 per acre, totaled \$2,315,606. The state realizes the most income when wells are successfully drilled and it receives a royalty of 13 per cent on oil and 12-1/2 per cent on gas. In FY 1987, royalties totaled \$3,466,628.

An article in the Public Land Law Review, Volume 3, 1982, dealt with school trust lands and royalties. On the importance of royalties, it stated: "The royalty is the most important form of compensation, not only because it represents the most money, but also because it represents payment for the removal of the mineral."

State leasing activity and subsequent income to the trust have dropped significantly in recent years, and that is part of the reason that we are here. In the past five years, the number of acres under lease has declined 60%. Oil royalties have declined 56%, gas royalties 34%. Rentals have declined 59% and bonus bids are down a whopping 96%. The petroleum industry has also declined in the past three years, but not to this extent. For example, the price of oil has declined 40%, and production in Montana is down 22%.

Leasing of state minerals is an area in which it is important for Montana to become competitive with other states, and that is what this bill contemplates. We're not proposing to be better -- just to lease the way other states do.

The first change is to eliminate the rental on producing lands. Rental payments were originally established in oil and gas law to provide income to the lessor (the state, in this instance) until production is established and the lessor receives royalty income. In Montana, rentals have been charged on producing lands rather than compensation for surface damages. However, operators expect to pay for surface damages, reclaim the surface, and recompense the surface owner for land lost to production. Montana is the only state that charges rentals even when a royalty is being paid.

A partial refund of the drilling penalty is also proposed. The penalty is currently required even if the lessee is in the process of drilling. In many instances, it is less expensive for the lessee to drop and rebid the lease rather than pay the delay drilling penalty starting in the sixth year of the lease. The amendment worked out between Department of State Lands and industry provides for a refund of the penalty during the year in which a well is drilled.

The third proposal is to allow the lessee to drop a lease if it is not economic to drill an offset well. Under current statute, the lessee is forced either to drill an offset well or pay a compensatory royalty. This puts the state in the position of making economic decisions, rather than the operator.

Even in a downturn, the taxes paid by the petroleum industry in Montana are significant -- nearly \$108 million in state and local taxes and royalties last year. Looked at from the perspective of local governments, one 50-barrel oil well will generate as much local property tax as 6240 cows; 79,047 grazing acres or 11,773 acres of tillable land. And about 60% of the local property taxes on oil and gas support the local schools.

The same Public Land Law Review article quoted earlier said, "The only goal of state level management is the production of sustained income for the maintenance of the public schools."

Some change is necessary to halt the decline in state leasing, for the protection of the schools' income. HB 133 will help accomplish that.

SENATE NATURAL RESOURCES

EXHIBIT NO. 4DATE 2-2-89BILL NO. HB 133

TO: SENATE NATURAL RESOURCES COMMITTEE

FROM: JACK E. KING, LANDMAN
HANCOCK ENTERPRISES
Suite 500, Petroleum Building
Billings, MT 59101 252-0576
President, Montana Petroleum Association

RE: HB 133 STATE OIL & GAS LEASING BILL

The regulations for oil and gas leasing on State lands has several onerous features which this Bill addresses. The intent of this Bill is to remove glaring inconsistencies and make our regulations more consistent with our neighboring states and with common industry practice.

After the 5th year of a State lease the delay drilling penalty in 77-3-424 calls for an additional \$1.25 per acre per year rental penalty on top of the existing \$1.50 per acre per year rental, regardless of drilling activity on the lease. This "penalty" is unique among standard industry leases and among counterpart Rocky Mountain states. Therefore, we recommend the deletion of 77-3-424 "the delay drilling penalty".

Section 1: The change at the end of the Section (page 2, lines 7-9) frees producers from having to pay rentals and royalties. Common lease language dictates that once you establish production the lessee pays royalties, in lieu of rentals.

Section 3: Currently, if a non-producing State lease offsets a producing well, the State, as lessor, can demand that an operator pay compensatory royalties (royalties based upon estimated drainage) or require the operator to drill a test well. The new language affords the lessee the chance to drop the lease, if the lessee does not feel that the tract has sufficient merit to warrant further activity. There are a variety of reasons the lessee may want to drop the lease, the most obvious being they may not have the capital or desire to drill a test well or pay compensatory royalties. This clause specifically addresses unusual circumstances whereby the State would feel a tract is prospective and the lessee feels that the tract is not economic, at that particular time for that particular operator. If released by the lessee the State would put the tract back up for bid, at one of their sales, and receive the added benefit of additional bonus income with the stipulation of drilling a well or paying compensatory royalties.

Section 4. The deletion of the language "in addition to the rentals as hereinbefore provided" (page 4, line 6), addresses the same questions as Section 1, the elimination of paying royalty and rentals. As this type of language is unique to our State, it is yet another example thrown up to those of us living in Montana of "those guys (State of Montana) are out to get us".

Ex. #4

3-3-89

HB 133

HANCOCK ENT.

TEL No.406-252-1760

Mar 2,89 14:41 No.001 P.02

The changes that are made in this Bill are consistent with other Rocky Mountain states, and lends State Lands the benefit of being competitive with other states. As things currently stand, our regulations send another negative message to operators in this State, thus State lands are the last leases purchased and first leases dropped on a project.

SENATE NATURAL RESOURCES

EXHIBIT NO. 5

DATE 3-3-89

BILL NO. HB 133

Testimony of John F. North
Department of State Lands
Senate Natural Resources Committee
March 3, 1989

The Department of State Lands supports HB 133. Current law provides that a state oil and gas lessee must continue to pay rentals even though the lease is producing and the lessee is paying royalties. Most private and federal leases and leases of other states provide that the rentals are credited against royalties. Section 1 of HB 133 would insert a similar provision in state leases.

Those rentals have in the past been charged in lieu of surface damage payment to the state. The state will now begin to assess surface damages. However, if the lessee properly reclaims the site, this process will be less expensive to the lessee. Thus, it is likely that the state's surface will be better reclaimed and the lessee's costs will decrease.

Section 3 merely places in law the current practice of the Board of Land Commissioners to allow a state lessee to drop a lease in lieu of drilling an offset well or paying compensatory royalties if drainage of the state tract from a well off the state tract is occurring or is about to occur. Of course, the lessee is required to reimburse the state for any drainage that has occurred before cancellation as a result of the lessee's negligence.

Finally, Section 5 affects what are known as delay drilling penalties, which are additional rentals that a lessee must pay for each of the second five years of the ten year lease term on which he does not drill a well or operate an existing well. These penalties are payable annually in advance. Section 5 merely provides that this advance payment is refundable for any year in which the lessee drills a well.

In summary, HB 133 would make the state lease more attractive to potential lessees, may thereby increase lease activity on trust lands, and would better protect trust lands. For these reasons, the Department supports HB 133.

SENATE STANDING COMMITTEE REPORT

March 3, 1989

MR. PRESIDENT:

We, your committee on Natural Resources, having had under consideration HB 133 (third reading copy -- blue), respectfully report that HB 133 be concurred in.

Sponsor: Hayne (Keating)

BE CONCURRED IN

Signed: Thomas F. Keating

Thomas F. Keating, Chairman

2-3-89
4:00
JF

HOUSE BILL NO. 133

INTRODUCED BY HAYNE, IVERSON, D. BROWN, GILBERT, KEATING.

REHBERG, GAGE, MEYER, ABRAMS, TVEIT, GERVAIS

A BILL FOR AN ACT ENTITLED: "AN ACT GENERALLY REVISING LAWS RELATING TO PAYMENT OF RENTALS, DELAY DRILLING PENALTIES, COMPENSATORY ROYALTIES, AND ROYALTIES ON STATE OIL AND GAS LEASES; ~~ELIMINATING AUTHORITY TO TERMINATE LEASES IN THE ABSENCE OF DRILLING OR PAYMENT OF DELAY DRILLING PENALTIES; PROVIDING FOR REFUND OF DELAY DRILLING PENALTIES FOR YEARS IN WHICH DRILLING OCCURS; AMENDING SECTIONS 77-3-423, THROUGH 77-3-425, 77-3-427, AND 77-3-432, AND 77-3-434, MCA; REPEALING SECTION 77-3-424, MCA; AND PROVIDING AN EFFECTIVE DATE AND AN APPLICABILITY DATE.~~"

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 77-3-423, MCA, is amended to read:

"77-3-423. Annual rental. (1) The annual money rentals to be paid to the state for oil and gas leases issued on and after July 1, 1975, shall be set by the board but may not be less than \$1.50 for each acre of land leased.

(2) In addition to the sum of \$1.50 per acre, the rental for the first year of the lease shall also include any sum in excess of \$1.50 per acre offered and accepted for the first year's rental.

(3) This annual rental shall in no case be less than \$100 a year.

(4) The first year's rental shall be paid before the issuance of the lease. The rentals for each subsequent year of the lease shall be due and payable before the beginning of such subsequent year, and upon failure to make such payment, the lease terminates unless there is a producing well on the lease. Rental paid for any year shall be credited against any royalty that accrues during that year."

Section 2. Section 77-3-425, MCA, is amended to read:

"77-3-425. Dry hole clause. If the first well drilled is a dry hole and if a second well is not commenced on the land covered by the lease before the next anniversary of the lease following the completion of the well, the lease may be terminated by the board unless the lessee, on or before such anniversary, ~~resumes the payments of penalties in the amounts provided in 77-3-424. Upon the resumption of the payment of such delay drilling penalties and their continued payment, the lease continues in force during the primary term as though there had been no interruption in the delay drilling penalty payments continues to pay an annual rental as set forth in 77-3-423~~ RESUMES PAYMENT OF ANY DELAY DRILLING PENALTIES IMPOSED BY THE BOARD. UPON THE RESUMPTION OF PAYMENT OF ANY REQUIRED DELAY DRILLING PENALTIES AND THEIR CONTINUED PAYMENT, THE LEASE CONTINUES

1 IN FORCE DURING THE PRIMARY TERM AS THOUGH THERE HAD BEEN NO
2 INTERRUPTION IN THE DELAY DRILLING PENALTY PAYMENTS."

3 **Section 3.** Section 77-3-427, MCA, is amended to read:

4 "77-3-427. Provision for offset wells -- compensatory
5 royalties. (1) Oil and gas leases granted by the state shall
6 contain suitable provisions imposing upon all lessees the
7 obligation to drill offset wells wherever and whenever
8 necessary to prevent waste and damage to the property of the
9 state.

10 (2) The board may allow the lessee the option of
11 following options in lieu of drilling an offset well:

12 (a) releasing the lands in question; or

13 (b) paying a compensatory royalty on a nonproducing
14 lease in--lieu--of--drilling-an-offset-well if it THE BOARD
15 determines that such compensatory royalty will fully
16 compensate the state for waste and damage to the property of
17 the state. The compensatory royalty shall be based upon the
18 estimated drainage, as determined by the board, and shall be
19 paid on a monthly basis unless circumstances require
20 otherwise.

21 (3) IF THE BOARD OR THE LESSEE TERMINATES THE LEASE,
22 THAT TERMINATION DOES NOT IMPAIR ANY IMPLIED COVENANT
23 AGAINST DRAINAGE OR THE RIGHT OF THE BOARD TO SEEK DAMAGES
24 FROM THE LESSEE FOR THE LESSEE'S FAILURE TO PROTECT THE
25 LEASE FROM DRAINAGE OF OIL OR GAS BY A WELL ADJACENT TO THE

1 STATE LEASE."

2 **Section 4.** Section 77-3-432, MCA, is amended to read:

3 "77-3-432. Royalty. In every oil and gas lease granted
4 by the state under this part and acts amendatory thereto,
5 there shall be reserved to the state as consideration
6 therefor,---in--addition--to--the--rentals--as--hereinbefore
7 provided, a royalty in on IN all oil and gas produced and
8 saved from all lands covered thereby and not used for light,
9 fuel, and operation purposes on the leased premises, which
10 shall be equivalent to the full market value, as ascertained
11 by the board at the date of such lease, of the estate or
12 interest of the state in the lands and oil and gas deposits
13 disposed of under such lease. Such royalty reservation shall
14 be set by the board but may not be less than 12 1/2% on gas
15 and not less than 12 1/2% on that portion of the average
16 production of oil or casinghead gasoline for each producing
17 well not exceeding 3,000 barrels for the calendar month. The
18 state may share the expense of transporting the oil to the
19 nearest market on a basis proportional to the state's
20 royalty interest in such oil and at a rate per mile
21 acceptable to the department."

22 ~~**Section 5.** Section 77-3-434, MCA, is amended to read:~~

23 ~~"77-3-434. Manner of making royalty payment: Such A~~
24 ~~lease shall provide for the rendering of payment of such the~~
25 ~~royalty on all oil and gas produced and saved and sold or~~

used--off--the-premises-in-the-following-manner-and-upon-the
following-terms:

{1}--the-lessee-shall-pay-to-the-state-in-cash, for all
oil--and--gas--royalty--reserved,--the--posted--field--price
existing-on-the-day-such-oil-or-gas-is-run-into-any-pipeline
or--storage-tank-to-the-credit-of-the-lessee, plus any bonus
actually-paid-or-agreed-to-be-paid-to-the-lessee--for--such
oil-or-gas; or

{2}--at--the--option-of-the-state, exercised-in-writing
by-the-board-not-oftener more-frequently than-every-30-days,
the-lessee-shall-deliver-the-state's-royalty-oil-or-gas free
of-cost-or-deductions into-the-pipeline-to-which--the--wells
of---the--lessee--may--be--connected--or--into--any--storage
designated-by-the-state-and-connected-with-such-wells."

NEW SECTION. Section 6. Repealer. Section 77-3-424,
MCA, is repealed.

SECTION 5. SECTION 77-3-424, MCA, IS AMENDED TO READ:

"77-3-424. Power to terminate lease in absence of
commencement of drilling or payment of delay drilling
penalty. (1) In every oil and gas lease granted after March
3, 1955, under this part there shall must be reserved to the
board full power to declare termination of the lease at the
end of the fifth year or any subsequent year of the primary
term of the lease upon failure of the lessee to either:

(a) commence the drilling of a well for oil and gas

upon the leased premises; or

(b) pay a delay drilling penalty as follows:

(i) for the sixth year of the lease \$1.25 per acre per
year; and

(ii) for the remainder of the primary term of the lease
an amount per acre per year as the board may in its
discretion determine.

(2) Notice of that determination shall must be given
to the lessee, and if the lessee applies for a hearing
thereon within 10 days after receipt of the notice, the
determination shall-become becomes final only after such the
hearing has been held.

(3) This annual delay drilling penalty shall must be
paid each year in advance. The board shall refund delay
drilling penalties paid on a lease for any year in which the
lessee commences drilling on that lease.

(4) If a well for oil and gas is commenced, the
drilling of the well shall must be prosecuted with due
diligence and dispatch to such depth as is necessary to make
a reasonable test for oil or gas."

NEW SECTION. Section 6. Extension of authority. Any
existing authority to make rules on the subject of the
provisions of {this act} is extended to the provisions of
{this act}.

NEW SECTION. SECTION 7. APPLICABILITY. [THIS ACT]

HB 0133/02

1 APPLIES TO ALL LEASES ENTERED INTO AFTER [THE EFFECTIVE DATE
2 OF THIS ACT].
3 NEW SECTION. Section 8. Effective date. [This act] is
4 effective July 1, 1989.

-End-